91-2047

No._____

Supreme Court, U.S.
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In The
Supreme Court of the United States
October Term, 1991

Norwest Bank Duluth, N.A.,
Petitioner,
v.
Minnesota Commissioner of Revenue
and the State of Minnesota,
Respondents.

Cambridge State Bank, et al.,
Petitioners,
v.
Minnesota Commissioner of Revenue,
Respondent.

On Petition for Writ of Certiorari To The Minnesota Supreme Court

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The State of Minnesota imposed a tax on interest from obligations of the United States ("federal obligations") but exempted interest from certain state and local obligations ("state obligations"). The Minnesota Supreme Court initially recognized that the tax was discriminatory and unlawful under 31 U.S.C. § 742 as construed by this Court in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), but the court upheld the tax by applying *Memphis Bank* on a prospective-only basis. Petitioners filed a petition for certiorari requesting review of that decision. This Court granted the petition, vacated the judgment and remanded the case for reconsideration in light of *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). On remand, the Minnesota Supreme Court reversed its prior ruling and purported to apply *Memphis Bank* retroactively, but the court estopped Petitioners, denied refunds and awarded Petitioners a prospective-only remedy. The questions presented are:

1. Whether the Minnesota Supreme Court gave retroactive effect to this Court's decision in *Memphis Bank* as required by *Beam* when it denied refunds to Petitioners despite their compliance with state statutory refund procedures; and

2. Whether the Minnesota Supreme Court's decisions (i) to deny refunds to Petitioners despite their compliance with refund procedures, and (ii) to estop Petitioners because of their ownership of state obligations, violate the Due Process Clause and the Supremacy Clause.

LIST OF PARTIES AND RULE 29.1 STATEMENT

The parties to the proceedings in the Minnesota Supreme Court were: (1) Petitioners Norwest Bank Duluth, N.A. ("Norwest"), Cambridge State Bank ("Cambridge"), First Security State Bank of Sleepy Eye ("First Security") and Midway National Bank of St. Paul ("Midway"), and (2) Respondents John P. James, Commissioner, Minnesota Department of Revenue, and the State of Minnesota. The current Minnesota Commissioner of Revenue is Dorothy A. McClung.

The following is a Rule 29.1 listing of parent companies of the Petitioners and subsidiaries of the Petitioners other than wholly-owned subsidiaries.

Norwest Bank Duluth, N.A.
Norwest Corporation

Cambridge State Bank
None

First Security State Bank of Sleepy Eye
First Sleepy Eye Bancorp

Midway National Bank of St. Paul
None

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PETITION FOR WRIT OF CERTIORARI

The Petitioners respectfully ask that a writ of certiorari issue to review the judgment of the Minnesota Supreme Court entered in the above-entitled proceeding.

OPINIONS BELOW

The opinion of the Minnesota Supreme Court (Yetka, J.) is reported at 480 N.W.2d 647, and is reprinted in the appendix hereto at App. 1A. An earlier opinion of the Minnesota Supreme Court (Yetka, J.) is reported at 457 N.W.2d 716, and is reprinted in the appendix hereto at App. 19A. Petitioners obtained an order from this Court on June 28, 1991, vacating the judgment that was entered as a result of that earlier decision and remanding the case for further consideration in light of *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). This order appears at 111 S. Ct. 2881, and is reprinted in the appendix hereto at App. 18A.

The Minnesota Supreme Court in its decision on remand affirmed in part and reversed in part unreported decisions of the Ramsey County District Court (the Honorable Harold Schultz) rendered in bifurcated proceedings. The district court's decisions in Phases I and II of the trial are reprinted in the appendix hereto at App. 36A and App. 51A respectively.

JURISDICTION

The judgment of the Minnesota Supreme Court was entered on April 2, 1992, and is reprinted in the appendix hereto at App. 69A. Jurisdiction to review that judgment by writ of certiorari is conferred upon this Court by 28 U.S.C. § 1257(a).[1]

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[1] The petition is timely filed within 90 days of the judgment. See *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 307 n.18 (1978).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The United States Constitution article VI, clause 2 (the "Supremacy Clause"), provides in relevant part:

> This Constitution, and the laws of the United States which shall be made in pursuance thereof, . . . shall be the supreme law of the land, and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding.

The United States Constitution amendment XIV, § 1 (the "Due Process Clause"), provides in relevant part:

> . . . nor shall any state deprive any person of . . . property without due process of law, . . .

During the 1979 tax year at issue, Rev. Stat. § 3701, then set forth at 31 U.S.C. § 742 ("Section 742"), provided as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

This statute is now codified, with minor amendments not affecting a substantive change in the law, at 31 U.S.C. § 3124(a).

During 1983, the year Petitioners filed claims seeking refunds of bank excise tax, the procedures for obtaining refunds were prescribed by Minn. Stat. § 290.50 (1982 and Supp. 1983) ("Section 290.50"), the text of which is reprinted in the appendix hereto at App. 72A-73A. The text of other relevant Minnesota statutes is reprinted in the appendix hereto at App. 70A-71A and App. 74A-75A.

STATEMENT OF THE CASE

During 1979, Minnesota imposed an excise tax on banks measured by net income. Minn. Stat. § 290.361 (1978). Interest on federal obligations was taxable while interest on certain state obligations was exempt. Petitioners paid the tax on federal obligation interest for 1979 and thereafter timely filed claims for refund following the procedures set forth in Section 290.50. (App. 40A, 72A-73A.) Petitioners asserted as a basis for their claims that the Minnesota bank excise tax was discriminatory in violation of Section 742 and the intergovernmental immunity doctrine. In support of their claims, they cited *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which held a nearly identical Tennessee tax to be discriminatory and unconstitutional. After the expiration of a statutory six-month waiting period during which the Minnesota Commissioner of Revenue (the "Commissioner") failed to act upon their claims, Petitioners timely filed refund actions in Ramsey County District Court against the Commissioner and the State of Minnesota, again following the

procedures set forth in Section 290.50.[2] (App. 40A.)

The trial court held that the bank excise tax discriminated against federal obligations[3] (App. 41A) and awarded refunds under Section 290.50. (App. 65A.) In its initial decision dated July 20, 1990, the Minnesota Supreme Court reversed. The court agreed that the tax was discriminatory (App. 24A), but nonetheless held that the bank excise tax should be treated as lawful for 1979 on the theory that this Court's 1983 *Memphis Bank* decision announced a new rule of law that should be applied on a prospective-only basis.[4] (App. 31A-34A.)

Petitioners filed a petition for a writ of certiorari with the United States Supreme Court requesting review of the Minnesota Supreme Court's decision. While the petition was pending, the Court decided *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). Because of the impact of *Beam* upon the issues

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[2] Petitioner Norwest filed suit for the 1979 year only. Petitioners Cambridge, First Security and Midway, together with approximately 200 other banks, filed suit for the years 1979 through 1983 in a separate action, which was consolidated with the Norwest suit by the district court. By agreement of counsel and order of the district court, Petitioners Cambridge, First Security and Midway were selected as "test banks" from among the numerous plaintiffs in the case, and 1979 was selected as the "test year." Judgment was entered as to the test banks for the 1979 test year in accordance with Minnesota Rules of Civil Procedure 54.02, which permits final judgment with respect to fewer than all of the claims or parties when there is no just reason for delay. In briefs filed below, the Commissioner has asserted that approximately 700 banks in Minnesota have claims similar to those here at issue.

[3] The trial court determined on the basis of expert economic testimony that there would be an annual increase in federal borrowing costs of $1.75 billion if all states adopted discriminatory bank excise taxes similar to the Minnesota tax, and this finding was affirmed on appeal. (App. 46A; App. 26A.)

[4] The court also held that Petitioners were estopped from claiming refunds and that it could award Petitioners purely prospective relief, as discussed below.

addressed by Petitioners' petition for writ of certiorari, the Court granted the petition, vacated the judgment of the Minnesota Supreme Court, and remanded the case for further consideration in light of *Beam*. (App. 18A.)

On remand, the Minnesota Supreme Court reversed its original holding that *Memphis Bank* applied prospectively only and held that the bank excise tax violated Section 742. (App. 7A.) However, the court held that because of the "state's equitable interests (its potential liability)" it would not award refunds under Section 290.50, but rather would award "purely prospective relief."[5] (App. 15A-17A.) The court distinguished *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990), which struck down a similar state court decision, because *McKesson* was a Commerce Clause case involving "comparative economic disadvantage [to other taxpayers] caused by the discriminatory tax," whereas the damage in the instant case was to the Federal Government itself. (App. 30A.) The court also observed that the taxpayer in *McKesson* had no opportunity to challenge the tax other than to pay it and sue for a refund. (App. 15A.) The court stated that Petitioners had the option under state law to challenge the tax in the Minnesota Tax Court prior to paying it, but instead followed another option provided by state law -- the refund procedures of Section 290.50. (App. 15A.)

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[5] The court purported to award prospective relief by severing exemptions for state bonds on a prospective basis, an action having no practical effect since the Minnesota Legislature had previously repealed the exemptions following *Memphis Bank*. 1983 Minn. Laws Ch. 213. The constitutionality of this severance remedy was presented to and rejected by the trial court. (App. 53A-54A.) In its first decision, the Minnesota Supreme Court reversed the trial court and upheld the severance remedy. (App. 27A-31A.) On remand, the Minnesota Supreme Court reaffirmed its earlier holding. (App. 12A-17A.)

The court also held that Petitioners were estopped from challenging discrimination against federal obligations because Petitioners owned state obligations as well as federal obligations and "accepted the benefits" of state obligation tax exemptions. (App. 12A, 27A.) The court rejected Petitioners' argument that they could not be required to make a contribution to the State of taxes they did not owe (*i.e.*, taxes on exempt interest) as a precondition to challenging discrimination against federal obligations.[6] (App. 8A-12A.)

REASONS FOR GRANTING THE WRIT

I. Certiorari Should Be Granted to Resolve Whether a State Court May Prescribe a Purely Prospective Remedy for Unconstitutional Taxation Despite *Beam*'s Requirement That the Substantive Law Invalidating the Tax Be Applied Retroactively.

On May 18, 1992, this Court granted certiorari in *Harper v. Virginia Dept. of Taxation*, 242 Va. 322, 410 S.E.2d 629 (1991), *cert. granted*, 60 U.S.L.W. 3779 (1992), to decide whether under any circumstances the decision in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), may be "applied" prospectively only to defeat federal retirees' entitlement to refunds of an

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[6] The trial court, over Petitioners' objections, allowed Respondents to amend their answers to assert estoppel as a defense. (App. 38A.) Petitioners argued that estoppel was invalid under state law and was also unconstitutional. The trial court rejected estoppel as being "no longer the law in the State of Minnesota." (App. 47A.) In its first decision, the Minnesota Supreme Court reversed without specifically addressing Petitioners' claim that estoppel would be unconstitutional. (App. 26A-27A). On remand, the court considered and rejected Petitioners' assertion that estoppel would violate the Due Process and Supremacy Clauses. (App. 8A-12A.)

unconstitutional tax. Like the instant case, *Harper* had been remanded by the United States Supreme Court for reconsideration in light of *Beam*. *Harper v. Virginia Dept. of Taxation*, 111 S. Ct. 2883 (1991). The Virginia Supreme Court found *Beam* distinguishable and adhered to its earlier view that *Davis* could be applied prospectively only. 410 S.E.2d at 632. By contrast, the Minnesota Supreme Court reversed its earlier decision and held that *Memphis Bank* had to be applied retroactively. However, although the court purported to follow the *Beam* mandate on substantive law, it in fact subverted *Beam* through the charade of awarding Petitioners prospective-only relief.

This Court has spelled out the limitations upon prospective decisionmaking in several recent decisions. *See Beam*; *American Trucking Ass'ns v. Smith*, 496 U.S. 167 (1990); *Ashland Oil, Inc. v. Caryl*, 497 U.S. 916 (1990); and *National Mines Corp. v. Caryl*, 497 U.S. 922 (1990). The Court presumably will further clarify this issue in *Harper*. The instant case involves the closely related, but analytically distinct, issue of what constitutional standards apply to *remedies* for unconstitutional taxation. The question, simply put, is whether a state court can dodge the retroactive effect of a United States Supreme Court decision by applying so-called "equitable considerations" to defeat a remedy to which a taxpayer would otherwise be entitled under state law.

In *Beam*, Justice Souter's plurality opinion noted that "the remedial inquiry is one governed by state law," but also noted that this inquiry was "subject to constitutional thresholds," citing *McKesson*. *McKesson* held that a purely prospective remedy was a denial of due process. However, *McKesson* was a Commerce Clause case; the instant case involves a tax that violated a federal statute and the intergovernmental immunity doctrine. Moreover, the taxpayer in *McKesson* had only one way to challenge the tax

there at issue -- by paying it and suing for a refund. As construed by the Minnesota Supreme Court, Minnesota law offered parallel procedures analogous to those that apply under federal law. The Minnesota Supreme Court did not dispute that Petitioners complied fully with the state refund procedures prescribed by Section 290.50, but held (in an unprecedented decision) that Petitioners could have instead challenged the tax in the Minnesota Tax Court without paying it under an alternative statutory procedure. The court therefore distinguished *McKesson* and awarded purely prospective relief.

This case raises significant issues of constitutional remedial law. This Court has not heretofore addressed the remedy to which a taxpayer is entitled where a tax violates a federal nondiscrimination statute.[7] Nor has it considered the entitlement to refunds where a state follows the federal model and provides parallel prepayment and postpayment tax controversy procedures. Petitioners therefore respectfully request that the Court grant certiorari to consider these issues, which are not presented by the Petition for Certiorari in *Harper* yet which are vitally important if this Court's prospectivity jurisprudence is to have any meaning.[8]

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[7] This issue is currently pending in *Comerica Bank-Detroit v. Michigan, et al.*, No. 128955, slip op. at 4 (Mich. Ct. App. May 4, 1992), a Section 742 case in which the Michigan Court of Appeals following *Beam* applied *Memphis Bank* retroactively, but, citing the instant case, remanded to the trial court for reconsideration of whether "equities" might dictate a remedy other than refunds. The issue is also relevant to the numerous cases in which federal retirees have sought refunds for violations of 4 U.S.C. § 111, which are cited at pages 3-4 of the Petition for Certiorari in *Harper*, since a significant number of state courts will be faced with remedial issues if the *Davis* case is applied retroactively.

[8] The Petition for Certiorari in *Harper* addressed the issue of whether *Davis* should be applied retroactively and whether state-law prospectivity doctrine might

(footnote continued on following page)

Petitioners also request review of the Minnesota Supreme Court's holding that they were estopped from challenging discrimination because they purportedly received a tax benefit through their ownership of state obligations. If allowed to stand, this holding would eviscerate Section 742's prohibition against discriminatory taxation. The estoppel holding, which also raises an issue not presented by *Harper*, should be reversed for reasons set forth below.

II. Certiorari Should Be Granted to Resolve Whether *McKesson* Applies to Cases Brought Under the Supremacy Clause.

1. The Minnesota Supreme Court held that the appropriate remedy for a discriminatory tax imposed on federal obligations, but not state obligations, was to sever and strike down the tax exemptions for state obligations on a prospective basis. (App. 17A.) The court held that it did not have to provide a remedy for past discrimination in the form of refunds. This Court in *McKesson* rejected the argument that such purely prospective relief was an acceptable remedy for discrimination, describing a similar contention by the revenue authorities in that case as "contrived,"

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preclude refunds even if federal prospectivity doctrine required that *Davis* be applied retroactively. Petition for Certiorari at 2, 7, *Harper*. The Brief in Opposition argued that certiorari should be denied because the lower court's decision was based on independent and adequate state law remedial grounds. Brief in Opposition at 11-21, *Harper*. However, review of the Virginia Supreme Court's decisions in *Harper* discloses no consideration whatsoever of remedial or procedural issues other than denial of refunds "erroneously or improperly assessed" because, under state law, rulings declaring taxing schemes unconstitutional must be applied prospectively only. *Harper v. Virginia Dept. of Taxation*, 241 Va. 232, 401 S.E.2d 868, 873-4 (1991). By contrast, the remedial and procedural issues raised herein were squarely decided by the Minnesota Supreme Court.

"self-serving," and "inconsistent with the nature of the State's due process obligation." 496 U.S. at 42. The Minnesota Supreme Court purported to distinguish *McKesson* because it was a Commerce Clause case involving "considerations of comparative economic disadvantage which are not present here." (App. 14A.) This holding is indefensible.

McKesson's rejection of purely prospective relief cannot be limited to Commerce Clause cases. Indeed, the Supreme Court in *McKesson* discussed at length and explicitly relied upon *Montana Nat'l Bank v. Yellowstone County*, 276 U.S. 499 (1928), which involved the application of a federal statute (section 5219 of the Revised Statutes) requiring equality of treatment between national and state banks, and in which this Court ordered refunds of a discriminatory tax. 496 U.S. at 32-7, 39-43. Thus, the rejection of purely prospective relief is not limited to taxes that violate the Commerce Clause, but also extends to discriminatory taxes that violate federal statutes and the Supremacy Clause.

The Minnesota Supreme Court distinguished *Montana Nat'l Bank* because it involved "the same comparative economic disadvantage -- between federal- and state-chartered banks -- as that involved in other commerce clause tax cases." (App. 14A-15A.) It is certainly true that both *McKesson* and *Montana Nat'l Bank* involved discriminatory taxes that favored one class of taxpayers over another, so that it might have been possible for the state court to cure discrimination by ordering the collection of a retroactive equalizing tax from the favored class of taxpayers. *McKesson*, 496 U.S. at 43. The instant case is concededly different.

Minnesota favored issuers of state obligations, who were able to obtain lower interest rates on their borrowings because of the tax exemption. (App. 45A.) Minnesota disfavored the Federal

Government, which incurred higher interest costs on its borrowings because of the discriminatory tax. (App. 46A.) *See* footnote 3, *supra.* The Minnesota Supreme Court concluded that because this past discrimination could not be undone, Petitioners were not entitled to any meaningful remedy. This Court's precedents do not support this holding.

This Court in *McKesson* recognized that there would be cases where a tax was "beyond the State's power to impose" or where a taxpayer was "absolutely immune from the tax," so that "no corrective action by the State could cure the invalidity of the tax during the contested tax period." 496 U.S. at 39. In such a case, the Court held that the "State would have no choice but to 'undo' the unlawful deprivation by refunding the tax . . ." *Id.* The instant case is just such a case. A tax that discriminates against persons dealing with the Federal Government is "void" and hence "'may not be exacted.'" *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 752 (1961), *reh'g denied*, 366 U.S. 947 (1961); *Phillips Chem. Co. v. Dumas Indep. School Dist.*, 361 U.S. 376, 387, *reh'g denied*, 362 U.S. 937 (1960). The bank excise tax was thus "beyond the State's power to impose." *McKesson*, 496 U.S. at 39. Since there is no way to "cure the invalidity of the tax," the tax must be refunded. *Id.*

2. The purpose of the intergovernmental immunity doctrine is to protect the Federal Government. However, it is well settled that individuals and private entities who are subjected to discriminatory taxation on account of their dealings with the Federal Government are also entitled to constitutional protection. *Davis*, 489 U.S. at 814; *Memphis Bank; Moses Lake Homes;* and *Phillips Chemical Co.* Allowing such persons to challenge discriminatory taxes serves to protect the Federal Government since the economic burden of such taxes is borne by the Federal

Government. As a practical matter, because states (including Minnesota) commonly prohibit suits to enjoin the collection of taxes, private enforcement of rights protected by the immunity doctrine most often occurs in the context of an action for a refund of the unconstitutional tax. *See, e.g., Davis and Memphis Bank.* The Minnesota Supreme Court's decision, if not reversed, would effectively end private enforcement of immunity doctrine rights.

The threat to private causes of action under the immunity doctrine is a threat to the Federal Government itself. If refunds can be denied because a state court believes it would be inequitable to impose liability on a state in an intergovernmental immunity case, then state governments will be able to impose discriminatory taxes with impunity. Taxpayers will rarely have an incentive to challenge discrimination if there is no possibility of a refund. Indeed, if a challenge leads to a repeal of state obligation exemptions, as it did in Minnesota, taxpayers would be well advised to allow discrimination to persist. In this regard, it should be borne in mind that 28 U.S.C. § 1341 relegates taxpayers exclusively to the state courts to pursue actions under Section 742. This Court is the only federal court that can hear Petitioners' claims.

Respondents have suggested in their previous briefs that Petitioners have overstated the threat to the Federal Government since the Federal Government itself could bring actions to prevent discriminatory taxation under Section 742. However, while it is possible that the Federal Government could sue to prevent discrimination, a review of the numerous cases under that statute discloses not a single case in which the Federal Government has done so. The statute has been enforced exclusively through private actions. If the Minnesota Supreme Court's decision is allowed to stand, the deterrent to discriminatory taxation as a practical matter

will disintegrate.

3. The Minnesota Supreme Court's decision conflicts with a recent decision of the Ninth Circuit. *See United States v. City of Spokane*, 918 F.2d 84 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991). The court there held that an unlawful tax upon a federal instrumentality had to be refunded:

> That the [taxpayer] is entitled to relief can hardly be questioned. It is true that the exact form of relief is often left to the local governmental entity when a tax is struck down as unconstitutional. However, that is typically done in cases where there is a commerce clause violation which can be remedied in any one of a number of ways. That approach has no application here, for here, purely and simply, a tax has been exacted from a federal instrumentality. The only logical relief, aside from precluding further taxation, is to order the improperly taken monies refunded.

918 F.2d at 89 (citations omitted).

City of Spokane is flatly in conflict with the Minnesota Supreme Court's decision in the instant case. The Minnesota Supreme Court distinguished *McKesson* as a Commerce Clause case and held that it did not have to order refunds because the proper remedy was to award purely prospective relief. (App. 14A.) The Ninth Circuit also recognized a distinction between Commerce Clause and intergovernmental immunity cases, but reached the opposite conclusion: A tax that violates the intergovernmental immunity doctrine must be refunded. Petitioners ask that the Court grant certiorari to resolve the conflict and to reverse the decision of the Minnesota Supreme Court. If there be any doubt as to the need for certiorari, Petitioners request that the Court seek the views of the Solicitor General of the United States because of the paramount federal interest involved.

III. Certiorari Should Be Granted to Resolve Whether a State Court Can Deny Refunds of a Concededly Unconstitutional Tax, Despite Compliance by the Taxpayer with State Refund Procedures, on Grounds That the Taxpayer Might Have Used an Optional Prepayment Procedure.

1. As a second ground for distinguishing *McKesson*, the Minnesota Supreme Court held that the Petitioners had a "'meaningful opportunity to withhold payment and to obtain a predeprivation determination of the tax assessment's validity.'" (App. 15A.) By contrast, the taxpayer in *McKesson* had no opportunity to obtain a predeprivation determination. 496 U.S. at 38-9. The Minnesota Supreme Court therefore concluded that purely prospective relief could be awarded without violating the Due Process Clause.

As construed by the Minnesota Supreme Court, the procedures for contesting a tax applicable to the 1979 taxable year were roughly comparable to federal income tax procedures under which a taxpayer may contest a tax prior to paying it by petitioning the United States Tax Court, 26 U.S.C. § 6213, or alternatively by paying the tax and suing for a refund in a federal district court or the United States Claims Court. 28 U.S.C. § 1346(a)(1). A number of states follow this federal model under which taxpayers are given a choice with regard to contesting a tax,[9] although Florida in *McKesson* did not.

In Minnesota, a taxpayer against whom a deficiency is assessed by the Commissioner of Revenue may appeal the

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[9] *See, e.g.*, Ariz. Rev. Stat. Ann. §§ 42-124, 42-129 (1991); Conn. Gen. Stat. § 12-237 (1991); Md. Code Ann., Tax General § 13-510 (1992); Mich. Comp. Laws § 205.22 (1991); and N.D. Cent. Code §§ 57-38-39, 57-38-40, 28-32-15 (1991).

Commissioner's order to the Minnesota Tax Court without first paying the tax. Minn. Stat. §§ 271.01 and 271.06 (1980). Alternatively, the taxpayer may pay the tax and file a claim for refund with the Commissioner of Revenue. If the claim is denied or if there is no action on the claim within six months, the taxpayer can sue for a refund under Section 290.50 in state district court. *Id.* In a case upholding the constitutionality of the Minnesota Tax Court, the Minnesota Supreme Court observed that "it is crucial to note that the taxpayer *always has the option to file in district court*," and that "[t]his is perhaps the saving feature of this statutory scheme." *Wulff v. Tax Court of Appeals*, 288 N.W.2d 221, 225 (Minn. 1979) (emphasis added).

The Minnesota refund statute does not require payment under protest or duress. While common law precluded taxpayers from recovering a voluntarily paid tax, *Horn v. City of Minneapolis*, 182 Minn. 172, 234 N.W. 289 (1930), voluntarily paid taxes are recoverable under Minnesota's refund statutes. *Acton Constr. Co. v. Commissioner of Revenue*, 391 N.W.2d 828, 832 (Minn. 1986) (discussing sales tax refund statute substantially similar to Section 290.50); *In re Monfort's Estate*, 193 Minn. 594, 595-7, 259 N.W. 554, 555 (1935) (discussing estate tax refund statute).

Petitioners fully complied with the requirements of Section 290.50 by timely filing refund claims and timely filing suit in state district court. (App. 40A.) In similar cases involving unconstitutional taxes, the Minnesota Supreme Court has awarded refunds. For example, on remand from this Court's decision in *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575 (1983), which struck down on First Amendment grounds a use tax on newsprint and ink, the Minnesota Supreme Court vacated its earlier judgment upholding the tax and affirmed

the judgment of the district court awarding refunds. *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 332 N.W.2d 914 (Minn. 1983). In another recent case, the Minnesota Supreme Court held that Minnesota's income tax on mutual fund dividends derived from federal obligation interest violated 31 U.S.C. § 3124(a)[10] and affirmed the trial court's award of refunds under Section 290.50. *Yurista v. Commissioner of Revenue*, 460 N.W.2d 24 (Minn. 1990).

In fact, *no* Minnesota court prior to the instant case had ever denied refunds under a state refund statute for the reason that the taxpayer could have contested the tax in the Minnesota Tax Court without first paying it. Indeed, even in the instant case the Minnesota Supreme Court did not in its first decision hold that refunds should be denied because Petitioners could have litigated in the Tax Court. The theory was concocted to circumvent the *Beam* decision, which foreclosed the option of applying *Memphis Bank* prospectively only.

The State of Minnesota was under no obligation to adopt a statutory refund procedure. It might have adhered to the common law rule that required payment under compulsion, duress or protest in order to obtain a refund. Instead, it followed the federal model and provided for refunds of voluntarily paid taxes upon compliance with certain requirements, including the timely filing of a claim for refund and the timely filing of a lawsuit. The right of a taxpayer to the use of this procedure is a species of property protected by the Due Process Clause. *Cf. Logan v. Zimmerman Brush Co.*, 455 U.S. 422 (1982) (protectible property interest held to exist in fair employment procedure created by state statute). The Minnesota Supreme Court's refusal to award refunds

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[10] This federal statute is a subsequent codification of Section 742.

because of the "state's equitable interest (its potential liability)" arbitrarily deprived Petitioners of that interest. The cost of refunds cannot justify a decision to withhold refunds. *McKesson*, 496 U.S. at 51 n.35. Accordingly, Petitioners ask that the Court grant certiorari to reverse.

2. *McKesson* reaffirmed a long-line of cases in which this Court has held "that a [taxpayer] who denies the legality of a tax should have a clear and certain remedy." 496 U.S. at 32, *quoting Atchison, T. & S. F. Ry. Co. v. O'Connor*, 223 U.S. 280, 285 (1912). The underlying premise of the Minnesota Supreme Court's decision is that the Petitioners had a "clear and certain remedy" available to them since they could have withheld payment of the tax and appealed a subsequent assessment to the Minnesota Tax Court. The court observed: "Minnesota provided the banks with the required 'meaningful opportunity to withhold payment and to obtain a predeprivation determination of the tax assessment's validity.' *McKesson*, 110 S. Ct. at 2251." (App. 15A.) However, in 1980, the first year in which the Commissioner of Revenue might have issued an order in this case that would have been appealable to the Tax Court, state case law indicated that the only procedure available to challenge the constitutionality of a tax was the refund procedure followed by Petitioners in this case. Thus, the ability to challenge the bank excise tax in the Minnesota Tax Court was far from "clear and certain" in 1980.

The Minnesota Tax Court is an administrative agency of the executive branch of Minnesota state government. *Wulff, supra. Wulff* upheld the authority of the Tax Court to decide tax cases, in part because "the taxpayer always has the option to file in district court." *Id.* at 225. *Wulff* did not, however, consider whether the Tax Court could decide the constitutionality of a tax, an issue the Minnesota Supreme Court had explicitly reserved in an earlier

decision. *See Harris v. Commissioner of Revenue*, 257 N.W.2d 568, 569 n.1 (Minn. 1977).

In 1980, the Minnesota Supreme Court held that the Tax Court had no jurisdiction to decide constitutional issues in cases filed initially in the Tax Court. *Matter of McCannel*, 301 N.W.2d 910 (Minn. 1980); *Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138 (Minn. 1980). The court held further that the Tax Court's jurisdiction over constitutional issues extended *only* to cases transferred to the Tax Court by a district court. *McCannel*, 301 N.W.2d at 919-20; *Guilliams*, 299 N.W.2d at 139 n.1. Since taxpayers could not appeal an assessment of tax to the district court without first paying it and filing a refund claim as required by Section 290.50, *McCannel* and *Guilliams* were understood as requiring the payment of a tax prior to challenging its constitutionality. In light of these decisions, it can hardly be said that a prepayment appeal to the Tax Court was a "clear and certain remedy" available to Petitioners in 1980.[11]

This Court's decision in *Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673 (1930), is closely analogous. The taxpayer there sued to enjoin the collection of a Missouri bank stock tax on equal protection grounds. In its prior decisions, the Missouri Supreme Court had held that the state tax commission was without authority to provide relief from a discriminatory assessment, but that injunctive relief was available. These prior decisions were overruled by the state court in *Brinkerhoff-Faris*,

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[11] It is true that in a 1984 case, *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261, 264 (Minn. 1984), the Minnesota Supreme Court held that a constitutional issue could be decided by the Tax Court if the Tax Court first referred the case to a district court and if the district court then referred it back to the Tax Court. However, Petitioners can hardly be charged with having failed to foresee this 1984 development in 1980.

which held that the taxpayer should have exhausted its administrative remedies by petitioning the tax commissioner prior to suit. Since the period of limitations for filing an administrative claim had passed, the court held that the taxpayer was without a remedy. The United States Supreme Court reversed because the state court had "denied to the plaintiff due process of law -- using that term in its primary sense of an opportunity to be heard and to defend its substantive right." *Id.* at 678.

In similar fashion, the Minnesota Supreme Court has deprived Petitioners of their due process rights. Minnesota Supreme Court precedent for the year in question was that the Tax Court did not have the authority to decide constitutional issues and that the taxpayer always had the option of litigating in district court. Petitioners followed that precedent by paying the tax and suing for a refund in accordance with Section 290.50. Now, in an unprecedented decision, the Minnesota Supreme Court has held that Petitioners should have instead withheld payment of the tax and appealed to the Tax Court. Since this option is no longer available to Petitioners, they have been deprived of all opportunity to obtain a remedy for the imposition of an unconstitutional tax. Petitioners ask that this Court grant certiorari to reverse.

3. Petitioners herein fully complied with Minnesota refund procedures. The Minnesota Supreme Court did not hold otherwise. Nonetheless, it did hold that their failure to use an alternative Tax Court procedure that was not even available under then-existing law was a justification for the court's refusing to award refunds because it did not want to impose a liability on the State. Under this holding, the court has reserved to itself the authority to deny refunds on a wholly arbitrary basis, according to its view of the equities (*i.e.*, the cost to the State), in cases where taxpayers sue to vindicate federal rights.

Even if this reservation of arbitrary authority were acceptable as a matter of due process, the court's holding that it could exercise this so-called equitable power because of the Petitioners' failure to use the Tax Court procedure is not an independent state ground adequate to defeat Petitioners' federal rights. This Court has "often pointed out that state procedural requirements which are not strictly or regularly followed cannot deprive us of the right to review." *Barr v. Columbia*, 378 U.S. 146, 769 (1964). In deciding federal issues, state courts must apply procedural rules "evenhandedly to all similar claims." *Hathorn v. Lovorn*, 457 U.S. 255, 263 (1982), *reh'g denied*, 458 U.S. 1131 (1982); *NAACP v. Alabama*, 357 U.S. 449, 457 (1958).

The Minnesota Supreme Court has not "strictly or regularly" required taxpayers to use the Tax Court prepayment procedure rather than the statutory refund procedure. In fact, its holding in this case is novel, capricious, and manifestly promulgated for the sole purpose of defeating Petitioners' legitimate claim under a federal statute. As previously noted, other taxpayers choosing to use the refund rather than the prepayment procedure have obtained refunds. Indeed, an individual taxpayer bringing suit under the *same* refund statute that is here at issue, and claiming a violation of the *same* federal statute that is here at issue, was awarded a refund by the Minnesota Supreme Court in the month following the court's first decision denying refunds to the Petitioners. *See Yurista, supra.*

In *Ward v. Board of County Comm'rs*, 253 U.S. 17, 22 (1920), this Court held that a taxpayer could not be denied a tax refund on "non-Federal grounds of decision that were without any fair or substantial support." *See also Lawrence v. State Tax Comm'n*, 286 U.S. 276 (1932). Since Petitioners fully complied with Minnesota's refund procedures, the denial of refunds is

neither fair nor substantial. Petitioners' federal rights have been abrogated by an arbitrary, ad hoc decision. Petitioners ask the Court to grant certiorari to reverse.

IV. Certiorari Should Be Granted to Resolve Whether a State Court Can Estop a Taxpayer from Challenging a Tax That Discriminates Against Federal Obligations Because the Taxpayer Owns Exempt State Obligations.

Petitioners owned state obligations which bore interest that was exempt from tax under state law. The Minnesota Supreme Court held that because Petitioners "accepted the benefits" of these tax exemptions, they were estopped "from asserting the unconstitutionality of the Minnesota bank tax [on federal obligations]." (App. 7A.)

The tax exemptions for state obligations were by statute available to all holders of the bonds. Under the Minnesota Supreme Court's estoppel theory, Petitioners apparently would have had to forego the exemptions available to all other bond holders and pay a tax on state obligations in order to bring an action under Section 742. As a precondition to challenging a discriminatory tax on federal obligations, Petitioners would have had to pay an alternative form of discriminatory tax on state obligations. Such discrimination itself runs afoul of Section 742 and the intergovernmental immunity doctrine.[12] It also violates the

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[12] No taxpayer has ever been estopped by this Court (or any other court) under the Minnesota Supreme Court's theory. If the theory were valid, then the taxpayer in *Memphis Bank* should have been estopped. Memphis Bank had exempt interest income of $348,348 "on an investment of between $11 and $16.5 million in obligations of the State of Tennessee and its political subdivisions." Brief for Respondent at 35 n.5, *Memphis Bank*. The taxpayer in *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935), an earlier case similar to *Memphis*

(footnote continued on following page)

Due Process Clause and the Supremacy Clause. A state may not "defeat or handicap a valid national objective by threatening to withdraw state benefits" from persons exercising federal rights. *Nash v. Florida Indus. Comm'n*, 389 U.S. 235, 239 (1967).

Moreover, this is yet another instance in which the court's decision does not have "a fair or substantial basis." *Lawrence*, 286 U.S. at 282 (1932). The "benefit" purportedly accepted by Petitioners was wholly illusory. Interest rates on exempt state obligations were lower than they would otherwise have been if the obligations had been taxable. (App. 45A.) Thus, while Petitioners received a tax exemption, they also received less interest from state obligation issuers because of the subsidy the tax exemption provided. The issuers of state obligations, whose interest costs were reduced, received the benefits of the exemptions here at issue, not the holders of those obligations. The acceptance-of-benefits doctrine does not apply when a benefit is "inapparent." *Kadrmas v. Dickinson Pub. Schools*, 487 U.S. 450, 457 (1988).[13]

It should also be noted that this Court has not recognized the application of the acceptance of benefits doctrine unless the claimant received a benefit from the very statute claimed to be unconstitutional. *Kadrmas*, 487 U.S. at 457. Petitioners did not challenge the state obligation exemptions, the benefits of which they purportedly received. *See* Minn. Stat. § 474.12 (Supp. 1979) *and* Minn. Stat. § 136.32 (1978). (App. 74A-75A.) Rather,

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Bank, also should have been estopped. Schuylkill Trust owned "shares of Pennsylvania corporations, exempt from tax, of the value of $135,787." 296 U.S. at 117.

[13] The Minnesota Supreme Court conceded that the economic benefit to Petitioners was "'wholly illusory,'" but held (confusingly) that the tax exemption was nonetheless a "'benefit' they received." (App. 11A-12A.)

petitioners challenged the tax on federal obligation interest. *See* Minn. Stat. § 290.08, Subd. 13 (1978) (App. 70A.) They received no benefit from this tax. Receipt of benefits under one provision of state law does not act as an estoppel to a challenge of a "different provision of state law."[14] *Kadrmas*, 487 U.S. at 457.

This Court has applied the acceptance-of-benefits doctrine only where a claimant has sought to retain benefits under a statute while challenging one of the conditions of obtaining the benefits. *Kadrmas*, 487 U.S. at 456; *Fahey v. Mallonee*, 332 U.S. 245 (1947) (federal savings and loan estopped from challenging conditions in statute under which it was organized); *United States v. San Francisco*, 310 U.S. 16 (1940), *reh'g denied*, 310 U.S. 657 (1940) (city cannot sue to invalidate one of the conditions under which it accepted a federal land grant). It has not "generally forbidden" challenges to statutes simply because plaintiffs have derived some benefit under state law. *Kadrmas*, 487 U.S. at 456-7. Petitioners therefore ask the Court to grant certiorari to reverse the Minnesota Supreme Court.

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[14] Estopping a taxpayer from challenging a statute because the taxpayer received benefits under a different statute is inherently inequitable. Under the Minnesota Supreme Court's view, Petitioner Cambridge is estopped from recovering tax on $612,697 of federal obligation interest for having failed to pay tax on only $70,911 of state obligation interest. The detriment suffered by Cambridge is wholly disproportionate to the benefit allegedly received. Petitioners other than Cambridge also received significantly less state obligation interest than federal obligation interest.

CONCLUSION

For the reasons set forth above, Petitioners request that this petition for certiorari be granted.

Respectfully submitted,

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STATE OF MINNESOTA

IN SUPREME COURT

No. C0-89-2097

United States Supreme Court — Yetka, J.

Cambridge State Bank, et al.,

Respondents,

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Respondent,

vs.

John P. James, Commissioner, Department of Revenue, and the State of Minnesota,

Appellants.

Filed February 14, 1992
Office of Appellate Courts

S Y L L A B U S

1. The United States Supreme Court decision in James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991), requires retroactive application of the substantive rule of federal law established in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983).

2. The Beam decision preserves the state's right to raise procedural bars to an otherwise required retroactive application of a federal substantive rule.

3. The Beam decision preserves the state's right to

fashion an appropriate remedy for the violation of a substantive rule of federal law, at least where the case originates in state court.

The judgment of the trial court is affirmed in part and reversed in part.

Heard, considered and decided by the court en banc.

OPINION

YETKA, Justice.

The court first decided this tax refund case on July 20, 1990. Cambridge State Bank v. Roemer, 457 N.W.2d 716 (Minn. 1990). The United States Supreme Court granted certiorari, vacated, and remanded the cause to this court following its decision in James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991).

When the case was first before this court, respondent banks challenged Minnesota's pre-1983 bank excise tax, Minn. Stat. § 290.361 (1984) (repealed 1987), which included interest from federal obligations in computing net income (on which the bank tax was measured), while exempting interest from certain state obligations. The banks claimed that the tax was a discriminatory income tax in violation of 31 U.S.C. § 3124(a) (1982). That section reads in pertinent part:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, *except*--
>
> (1) *a nondiscriminatory franchise tax* or another nonproperty

> tax instead of a franchise tax, imposed on a corporation * * *.

Id. (emphasis added).

We held that the tax was a franchise rather than income tax, but agreed with the banks and the trial court that the tax was discriminatory because of its disparate treatment of state and federal obligation interest income. Cambridge State Bank, 457 N.W.2d at 719. Even though we found the tax discriminatory, we denied the banks a refund of the taxes paid on the federal interest income. We articulated three reasons for this denial.

First, we held that the banks should have been estopped from attacking the constitutionality of the bank tax's inclusion of federal obligation interest income because they had accepted the benefits of the state obligation interest exemptions. Cambridge State Bank, 457 N.W.2d at 720. Justice Kelley did not join in this part of the court's opinion. Id. at 723.

Second, we held that the proper remedy in this case was to sever the unconstitutional provisions of the tax because it was clear that the legislature would have enacted the tax statute without the unconstitutional provisions. Id. at 720-21.

Finally, we held that the United States Supreme Court's decision in Memphis State Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), which held a nearly identical tax unconstitutional and was the authority under which this court found Minnesota's bank tax discriminatory, applied prospectively only under the three-part test in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971). The Chevron case established the factors governing the non-retroactive application of judicial decisions. Cambridge State Bank, 457 N.W.2d at 722.

On August 2, 1991, this court ordered that the parties brief the specific issue of what effect, if any, the Beam decision has on the holdings in this case.

The United States Supreme Court's vacation of Cambridge State Bank v. Roemer leaves that decision without force or effect. State v. Hershberger, 462 N.W.2d 393, 395 (Minn. 1990) (citing Threlkeld v. Robbinsdale Fed'n of Teachers, Local 872, AFL-CIO, 316 N.W.2d 551, 552 (Minn.), appeal dismissed, 459 U.S. 802 (1982)). This court is not bound by and need not defer to the trial court's determination of legal questions in this case. A. J. Chromy Constr. Co. v. Commercial Mechanical Serv., Inc., 260 N.W.2d 579, 582 (Minn. 1977).

The issues presented by this remand order are:

I. Does Beam require retroactive application of the substantive rule of federal law established in Memphis Bank & Trust Co. v. Garner?

II. Does Beam preserve the state's right to raise procedural bars to an otherwise required retroactive application of a federal substantive rule?

III. Does Beam preserve the state's right to fashion an appropriate remedy for the violation of a substantive rule of federal law, at least where the case originates in state court?

I.

This court held that the rule enunciated in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983) invalidated Minnesota's bank tax as discriminatory under 31 U.S.C. § 3124(a) (1982), but denied refunds to the banks on the ground that the Memphis

Bank rule applied prospectively under Chevron Oil Co. v. Huson, 404 U.S. 97 (1971). Cambridge State Bank, 457 N.W.2d at 722-23. Although there is no majority rationale in Beam, six justices agreed that the prospective application of a rule announced in any given civil case is either prohibited or severely limited by constitutional restraints.[1] We hold that our original prospective application holding does not survive in Beam's wake.

In Beam, the James B. Beam Distilling Company had sought a tax refund of $2.4 million from the state of Georgia for the imposition of a liquor tax that distinguished between imported and local alcoholic products. 111 S. Ct. at 2442. In Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984), the U.S. Supreme Court had invalidated, under the commerce clause, an identical Hawaiian tax. The question squarely presented to the Court in Beam was whether the Bacchus ruling should apply retroactively to claims arising on facts antedating that decision. The state court, using a Chevron Oil analysis, had held that Bacchus did not apply retroactively. 111 S. Ct. at 2442.

Justice Souter's Beam opinion held that the retroactive application of a rule announced in a civil case is, in the first instance, a choice-of-law (rather than remedial) question "'between the principal of forward operation and that of relation backward.'" 111 S. Ct. at 2443 (quoting Great Northern Ry. Co. v. Sunburst Oil & Refining Co., 287 U.S. 358, 364 (1932)). Where the decisional rule derives from federal law, constitutional or otherwise, the

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[1] Justice Souter announced the judgment of the Court and delivered an opinion in which Justice Stevens joined. Justices White, Blackmun, Marshall and Scalia concurred in the judgment.

choice-of-law question of retroactivity is a federal one. Id. The general rule is one of retroactivity; if an opinion does not "reserve the question whether its holding should be applied to the parties before it * * * it is properly understood to have followed the normal rule of retroactive application in civil cases." Id. at 2445. Thus, under Justice Souter's analysis, it is error "to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so. * * *[P]rinciples of equality and *stare decisis* * * * prevail[] over any claim based on a Chevron Oil analysis." Id. at 2446.

Justice Souter's main concern with the Chevron Oil analysis is the consideration of equities, in the first instance, in determining whether a rule of law should not apply retroactively. Id. at 2448 ("The applicability of rules of law are not to be switched on and off according to individual hardship * * *."). Equitable and reliance interests, in Justice Souter's view, may be considered "when deciding remedial issues in particular cases," but only after the choice-of-law question has been settled. Id.

Our conclusion that the rule in Memphis Bank should not apply retrospectively under Chevron Oil fails under Justice Souter's analysis. First, Memphis Bank did not reserve the question of whether its holding should be applied to the parties before it; therefore, its holding applied both to those parties and retroactively. The state argues here that the United States Supreme Court was not required and did not reach the retroactivity question because the Memphis Bank parties stipulated to the result. However, the stipulation as to the result confuses the choice-of-law question with that of remedy. Remedial factors have no place in the consideration of whether a substantive rule of law applies in

the first instance in a given situation. Moreover, Memphis Bank's silence on the issue requires application of the "normal" rule of retroactivity.

Justice White concurred in Beam to emphasize that the Chevron Oil analysis might still apply in some situations, such as where a new rule is announced as a result of an express overruling of existing precedent. 111 S. Ct. at 2448-49. The concurrences of Justices Blackmun and Scalia conclude that the prospective application of new decisional rules "breaches [the Supreme Court's] obligation to discharge our constitutional function." Id. at 2449-51. Each of these three concurrences invalidates this court's holding that Memphis Bank applies prospectively only under Chevron Oil.

In light of the Beam decision, we hereby reverse our original conclusion in Cambridge State Bank that the rule in Memphis Bank applies only prospectively.

II.

This court held that the respondent banks were estopped, under the acceptance-of-benefits doctrine in tax cases, from asserting the unconstitutionality of the Minnesota bank tax. Because the banks accepted the tax benefits of the exemption for state obligation interest, the banks improperly challenged the unconstitutionality of the bank tax. Cambridge State Bank, 457 N.W.2d at 720. Although we have questioned the continued vitality of the acceptance-of-benefits doctrine in other areas of law, in Cambridge State Bank we reaffirmed the doctrine's use in tax cases. Id. We do so again on remand.

In stressing the distinction between the choice-of-law

question of retroactivity and that of remedy, Justice Souter indicated that "[n]othing we say here deprives [respondent state] of [its] opportunity to raise procedural bars to recovery under state law" and that Beam's retroactivity holding applies "with respect to all others not barred by procedural requirements or res judicata." 111 S. Ct. at 2446. We think this court's estoppel holding is one such state procedural bar.

Respondent banks argue that the estoppel theory is simply another method of applying the holding in Memphis Bank prospectively. We do not believe this argument undercuts Beam's express holding that this court may rely on an established state procedural bar to challenge a tax statute unless that prohibition is itself unconstitutional. Beam, 111 S. Ct. at 2443 (remedial inquiry subject to constitutional thresholds); see also McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, Dep't of Business Regulation of Florida, 110 S. Ct. 2238, 2250 (1990) ("Because exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause.").

Indeed, respondent banks have asserted that the estoppel theory is unconstitutional. They argue that the estoppel theory "in essence" required them to pay a tax that was not imposed on anyone else as a precondition to challenge the federal obligation interest taxation (i.e., they would have had to pay a tax on the exempted state bond interest before they would be allowed to challenge the tax on the federal obligation interest).

This argument ignores a significant point, however. For

the 1979-80 tax years,[2] Minnesota law did not require prepayment in order to challenge the validity of a tax. See Minn. Stat. § 271.09, subd. 3 (1978) (when appealing to the tax court, "the taxpayer shall pay at least the amount of the tax or other obligation conceded by the taxpayer to be due, if any, when it becomes due * * *." (Emphasis added.)). Respondent banks argue that the tax court did not have the authority to decide the constitutionality of a tax after our decisions in In re McCannel, 301 N.W.2d 910, 920 (Minn. 1980), and Guilliams v. Commissioner of Revenue, 299 N.W.2d 138, 139 n.1 (Minn. 1980). However, we believe that this argument confuses the issue of whether the banks could have challenged the tax at the time it was due without first paying it with the procedures for claiming a refund under the tax statute.

Before 1980, the tax court had subject matter jurisdiction over constitutional challenges to taxes assessed. Erie Mining Co. v. Commissioner of Revenue, 343 N.W.2d 261, 264 (Minn. 1984).[3] There was no prepayment requirement for bringing an

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[2] The parties stipulated that 1979 would be the "test year" for purposes of this litigation. Respondent banks have filed claims including 1980-1983 as well.

[3] In Erie Mining, we held:

> All tax matters over which the tax court has jurisdiction should be filed with the tax court. If any party raises a constitutional issue, the tax court should stay the proceedings and refer the constitutional question to the district court. The district court may either decide the constitutional issue or refer the matter back to the tax court which will than have subject matter jurisdiction to rule initially on the constitutional issue. If the tax court should declare any matter unconstitutional and no appeal is taken to this court, that ruling shall only be the law of the particular case involved.

appeal to tax court until 1987. See Minn. Laws ch. 268, art. 14, § 12 (codified at Minn. Stat. § 271.061 (1987 Supp.)) (repealed 1989). We think it is reasonable to assume that the banks would have avoided paying the tax at the time it was due by bringing their claims in tax court. More important, however, is the fact that, in each year at issue, the banks *could have* avoided paying the tax before challenging its constitutionality. Thus, there were sufficient procedural safeguards against unlawful exactions of the tax *at the time it was assessed.*

Even when there was a prepayment requirement, a taxpayer could avoid prepayment by showing:

> (1) That the proposed review is to be taken in good faith;
>
> (2) That there is probable cause to believe that the taxpayer may be held exempt from the tax or that the tax may be determined to be less than 50 percent of the amount due; and
>
> (3) That it would work a substantial hardship upon petitioner to pay the tax.

Minn. Stat. § 290.531 (1982) (repealed 1987).

Thus, respondent banks are incorrect in arguing that there were no "predeprivation processes" available to challenge the tax on the federal obligation interest at the time it was paid. Moreover, the processes available in Minnesota appear to satisfy the federal Constitution's due process requirements. See McKesson, 110 S. Ct. at 2250 (in satisfying the commands of the due process

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343 N.W.2d at 264.

clause, "[t]he State may choose to provide a form of 'predeprivation process,' * * * by authorizing taxpayers to bring suit to enjoin imposition of a tax prior to its payment * * *.").

Respondent banks also assert that the acceptance-of-benefits estoppel doctrine applies only where a claimant receives a benefit from the very statute challenged as unconstitutional. See Kadrmas v. Dickinson Pub. Schools, 487 U.S. 450, 457 (1988). While respondent banks note that they challenged the tax on the federal obligation interest, they fail to note that the tax was discriminatory *precisely because of* the state obligation interest exemptions. In other words, a tax based in part on federal obligation interest income is not per se discriminatory; only when that tax is read in conjunction with the state exemptions does its imposition become discriminatory.[4] Accordingly, although the tax and exemptions were imposed and granted in different chapters of Minnesota statutes, they must be read as part of one taxation scheme to be challenged in the first instance. Respondent banks' argument would elevate form over substance.

Finally, respondent banks assert that the "benefit" they received from the state obligation interest exemptions is "wholly illusory" because the state obligation exemptions cause the interest rates for those obligations to be lower than they would have been without the exemption. The trial court's findings of fact substantially support this claim.

On the other hand, the amount of profit generated (or not) by the lower interest rate is not the measure of whether the banks

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[4] In Kadrmas, there was no such nexus between the statute granting the "benefit" and that being challenged. 487 U.S. at 457.

received a "benefit." On the contrary, the banks did not pay taxes on *any* of the interest earned on the subject state obligations. Regardless of the interest rate the banks charged, the exemption from taxation was the benefit they received. Indeed, according to the trial court's findings, the state obligation interest exemptions "alone increase[d] the interest rates on certain federal obligations." Thus, the banks not only operated free from tax on the state obligation interest, but also received higher rates from federal borrowers.

Accordingly, we reaffirm our original acceptance-of-benefits estoppel holding as a state procedural bar to respondents' claims because the Beam decision expressly allows a state procedural law to prohibit the otherwise required retroactive application of a judicial decision.

III.

This court's third holding in Cambridge State Bank denied the respondent banks a refund of the taxes paid on the federal obligation interest for the years at issue. The court based its denial on the sufficiency of severance as a remedy for the discrimination caused by the tax. Under Minnesota's severance statute, Minn. Stat. § 645.20 (1988), we indicated that we could properly sever the discriminatory portion of the bank tax (i.e., the provisions exempting the state obligation interest). Cambridge State Bank, 457 N.W.2d at 720. When the legislature first enacted the bank tax, there were no state obligation interest exemptions; accordingly, the later exemptions (which caused the defect in the tax) cannot be said to have "invalidated the entire original Act." Id. at 720 (emphasis in original).

In addition, we ruled that the severance of the state exemptions in this case satisfied the due process requirement of providing an adequate post-deprivation remedy. Id. at 721. If a tax is unlawful under the commerce clause, the actual imposition of a curative tax or a refund of the tax exacted is required to equalize the comparative economic disadvantage caused by the discriminatory tax. See id.; see also McKesson, 110 S. Ct. at 2247 ("[T]he Due Process Clause * * * obligates the State to provide meaningful backward-looking relief to rectify any unconstitutional deprivation."). Here, there was no comparative economic disadvantage among competitors--each of the banks held both federal and state obligations. Accordingly, neither actual imposition of a curative tax nor refund of taxes paid was required. Cambridge State Bank, 457 N.W.2d at 721.

Finally, we noted that we would have assessed and collected a tax to cure the constitutional infirmity of the tax in question in spite of the Revenue Department's stipulation that it would not actually collect such a curative tax. Id. However, we did not impose the curative tax because we reasoned that, "[w]ere it not for our conclusion that the Memphis Bank case [applies prospectively] * * * we would order the Revenue Department to assess and collect the tax attributable to the state obligation interest income." Id. at 722.

In Beam, Justice Souter noted that, "[s]ubject to possible constitutional thresholds, the remedial inquiry is one governed by state law, at least where the case originates in state court." 111 S. Ct. at 2443 (citations omitted); accord American Trucking Ass'ns v. Smith, 110 S. Ct. 2323, 2348 (1990) (Stevens, J., dissenting) ("The remedial effect a decision of federal constitutional law

should be given is in the first instance a matter of state law."). Moreover, requiring retroactive application of a decisional rule does not deprive a party from demonstrating reliance and equitable interests in determining the nature of the remedy that must be provided. Beam, 111 S. Ct. at 2447-48; see also United States v. Estate of Donnelly, 397 U.S. 286, 297 (1970) (Harlan, J., concurring) ("To the extent that equitable considerations, for example, 'reliance,' are relevant, I would take this into account in the determination of what relief is appropriate in any given case.").

Thus, the Beam decision fundamentally affects the analysis a state court must undertake in fashioning a remedy in a case of this type. First, the "constitutional thresholds" to which Justice Souter referred were those enunciated in McKesson. There, the U.S. Supreme Court unanimously held that prospective relief from a tax invalidated under the commerce clause, by itself, does not satisfy the requirements of the due process clause where "a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a post-payment refund action in which he can challenge the tax's legality." 110 S. Ct. at 2247.

We distinguished McKesson on the ground that tax schemes invalidated under the commerce clause involve considerations of comparative economic disadvantage which are not present here. Here, the tax is applied to all banks in an equal manner. Respondent banks also contend that the United States Supreme Court's decision in Montana National Bank v. Yellowstone County, 276 U.S. 499 (1928), stands for the proposition that a refund of the taxes paid is the only remedy for a discriminatory tax even where the tax is not invalidated under the commerce clause. However, that case involved the same comparative economic

disadvantage--between federal- and state-chartered banks--as that involved in other commerce clause tax cases.

Moreover, McKesson is distinguishable on the ground that respondent banks' payment of the tax was not made under duress in the sense that payment was compelled in order to challenge the tax. As noted in part II above, Minnesota provided the banks with the required "meaningful opportunity to withhold payment and to obtain a predeprivation determination of the tax assessment's validity." McKesson, 110 S. Ct. at 2251 (footnote omitted). We think that purely prospective relief--the severance of the state obligation interest exemptions--is a sufficient remedy in this case.

The corporate banks in this case are in no better position than would be an individual taxpayer who challenged an entire income tax on the basis that only one part of the tax has been deemed infirm. For example, a taxpayer might be required by Congress or a state legislature to include income from certain investments, both state and federal, for income tax purposes. If the United States Supreme Court later held that the portion of the tax on federal investments were invalid, the taxpayer would not get far in arguing that the income on the state investments is exempt from taxation as well, resulting in no tax liability.

We think the severance remedy is also appropriate because the legislature has mandated it as a cure for an unconstitutional exaction of a tax. In 1983, after Memphis Bank was decided, the legislature cured the discriminatory impact of the tax by abolishing the exemptions for state obligation interest in the computation of gross income. See 1983 Minn. Laws ch. 213. In according proper deference to what the legislature has deemed an appropriate remedy, we think we are justified in holding severance to be a

suitable cure for the tax's discriminatory impact in this case.

Additionally, this court is entitled to consider "reliance" interests in fashioning a remedy in this case. Beam, 111 S. Ct. at 2447-48. Respondent banks may be correct in arguing that the state legislature would not have enacted the state obligation interest exemptions had it "relied" on state and federal case law. However, it would be incorrect to argue that the legislature would not have enacted a bank franchise tax based, at least in part, on federal obligation interest income. We believe the "reliance" interests to which Justices Souter, Stevens and Harlan all referred in this context are not so narrowly defined as to include only "reliance" on case law. Indeed, as this court pointed out in Cambridge State Bank, 20 years of unchallenged reliance on the validity of the tax involved here counters the notion that either the banks or the state did not "rely" on the tax scheme. 457 N.W.2d at 722.

We decline to penalize the state for relying on the tax scheme in this case by ordering a refund. We still believe the most appropriate remedy is to impose a curative tax. However, we believe the imposition of such a curative tax would be unconstitutional at this late date.[5] Moreover, in light of the lower interest

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[5] Although a curative tax for the years 1979-83 would cure the discrimination, we think it would be unfair to impose and collect a tax on the banks in this case. Indeed, the U.S. Supreme Court has held that

> the retroactive assessment of a tax increase does not necessarily deny due process to those whose taxes are increased, though beyond some temporal point the retroactive imposition of a significant tax burden may be "so harsh and oppressive as to transgress the constitutional limitation," depending on "the nature of the tax and the circumstances in which it is laid."

rates which the banks charge to its state borrowers, such a tax would penalize the banks unfairly.

Finally, the state's reliance interests are inextricably intertwined with the equities of the instant case. As we have noted, it would be inequitable, nearly impossible, and probably unconstitutional to impose a curative tax in this case. Nevertheless, simply because a curative tax cannot be imposed to remedy the discriminatory tax, it does not follow that the only alternative remedy is to refund the tax exacted. This reasoning would require us to ignore the state's equitable interests (its potential liability) while "overlooking" the fact that the banks could have challenged the tax at the time it was paid.[6] In this light, the equities of the case require the denial of the refunds requested.

We, therefore, reaffirm our original denial of the tax refunds sought by respondent banks, holding that the severance remedy is sufficient to cure the discriminatory tax in this case.

The judgment of the trial court is affirmed in part and reversed in part.

McKesson, 110 S. Ct. at 2252 n.23 (citing Welch v. Henry, 305 U.S. 134, 147 (1938)).

[6] It is interesting to note that in the first appeal to this court, the banks argued vigorously that Memphis Bank did not establish a new rule of law that would allow prospective application. Now, of course, the banks contend that their failure to challenge the tax at the time it was paid was due to a non-existent "prepayment" requirement.

SUPREME COURT OF THE UNITED STATES
No. 90-645

Norwest Bank Duluth, N.A.,

Petitioner,

v.

John P. James, Minnesota Commissioner of Revenue, et al.

ON WRIT OF CERTIORARI to the Supreme Court of Minnesota.

THIS CAUSE having been submitted on the petition for writ of certiorari and response thereto,

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this Court that the judgment of the above court in this cause is remanded to the Supreme Court of Minnesota for further consideration in light of *James B. Beam Distilling Company v. Georgia*, 501 U.S. (1991).

IT IS FURTHER ORDERED that the petitioner, Norwest Bank Duluth, N.A., recover from John P. James, Minnesota Commissioner of Revenue, et al., Three Hundred Dollars ($300.00) for its costs herein expended.

June 28, 1991

Clerk's costs: $300.00

IN SUPREME COURT

No. C0-89-2097

Ramsey County

Cambridge State Bank, et al.,
Respondents,

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),
Respondent,

vs.

Arthur C. Roemer, Commissioner, Department of Revenue, and the State of Minnesota,
Appellants.

Yetka, J.
Concurring specially, Kelley, J.

Filed July 20, 1990
Office of Appellate courts

SYLLABUS

1. A taxpayer who assumes the validity of a statute by invoking its provisions in order to obtain a tax benefit is estopped from attacking the statute's constitutionality.

2. Where it is clear that the legislature would have enacted a statute without the provisions which are unconstitutional, the proper procedure is to apply Minn. Stat. § 645.20 (1988) and sever the invalid provisions.

3. Pursuant to the three-part test set forth in Chevron Oil Co. v. Huson, 404 U.S. 97, 106-07 (1983), the United States Supreme Court's decision in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), must be applied prospectively.

Affirmed in part, reversed in part.

Heard, considered and decided by the court en banc.

OPINION

YETKA, Justice.

In the autumn of 1984, respondent banks commenced a tax refund claim in the district court of Ramsey County pursuant to Minn. Stat. § 290.50, subd. 2 (1988). This consolidated action by over 170 Minnesota banks sought tax refunds for the tax years 1979 through 1983. The district court concluded that the pre-1983 Minnesota bank excise tax imposed by Minn. Stat. § 290.361 (1984) (repealed 1987) is, in substance, an income tax and discriminates against federal debt instruments in violation of the borrowing and supremacy clauses of the United States Constitution. The court found that the inclusion of interest from federal obligations in the calculation of the banks' franchise tax was discriminatory and, therefore, in violation of 31 U.S.C. § 3124(a) (1982) (formerly numbered § 742)[7] because interest from certain state obligations was exempt from the calculation of the tax. The district court ordered the State of Minnesota to refund to respondents, with interest, taxes collected under the statute between 1979 and 1983.

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[7] 31 U.S.C. §3124 (1982) provides:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except---
>
> (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation * * *.

(Emphasis added.)

We affirm in part and reverse in part.

The record in this case includes a detailed stipulation of facts entered into by the parties. The trial was bifurcated into two phases: Phase I, a liability phase, and Phase II, a remedy phase. The issue of liability was tried before the court on November 6-17, 1986. By agreement of counsel and order of the court, evidence was presented by four banks for the 1979 tax year. The four banks were: Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The court heard lengthy and detailed testimony from several expert witnesses concerning the economic impact of the tax on the borrowing power of the federal government. The parties agreed that the conclusion of the court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States government, but did not include interest income earned by the banks on obligations of certain agencies of the State of Minnesota. Respondents filed timely protective claims for refunds for the tax year 1979 and timely filed these actions for refunds.

The trial court concluded that the tax violated 31 U.S.C. § 3124. In summary, section 3124 provides that obligations of the United States government are immune from state and local taxation, but interest earned on these obligations may be included in the measure of a "non-discriminatory" corporate franchise tax. The trial court concluded that the Minnesota tax was a discriminatory income tax and, therefore, violated the supremacy and borrowing clauses of the United States Constitution. The court's conclusion regarding discrimination was premised on a finding

that, under Minnesota law, interest earned on obligations of the United States Government was included in the computation of the corporate franchise tax whereas interest earned on certain obligations[3] of the State of Minnesota was exempt from the computation of the corporate franchise tax.

The trial court also concluded that, although the tax imposed by Minn. Stat. § 290.361 (1984) is labeled an "excise" tax, it is a direct tax on net income for purposes of federal statutory and constitutional law. The trial court rejected all of appellants' arguments and ordered that the appellants were liable for refunds in amounts to be determined in Phase II of the trial. On August 28, 1989, following phase II of the trial, the court ruled that appellants were liable for refunds, with interest, and ordered retroactive relief in the following amounts: Norwest-$189,065; Sleepy Eye-$36,278; Cambridge-$23,833; and Midway-$46,574. This appeal followed.

I. The first issue raised by this appeal is whether the bank tax imposed under section 290.361 and governed by Minn. Stat. § 290.02 (1988) is a non-discriminatory franchise tax. This court has determined that the tax imposed by section 290.02 is a

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[3] Appellants dispute the number of obligations that are exempt from the computation of the corporate franchise tax. Appellants concede, however, that at least two state/municipal obligations were exempt:

(1) Industrial Development Bonds issued under Minn. Stat. ch. 474 prior to June 30, 1979; and

(2) State University Bonds issued under Minn. Stat. § § 136.31-.38; Given that the parties have stipulated that at least some state obligations were exempt, this court need not reach the issue of whether the other types of obligations were actually exempt.

franchise tax. Reuben L. Anderson-Cherne, Inc. v. Commissioner of Taxation, 303 Minn. 124, 226 N.W.2d 611, appeal dismissed, 423 U.S. 886-87 (1975) (dismissed for lack of substantial federal question). Respondents ask this court to overrule Reuben on the grounds that, in "economic effect," the tax is an income tax. According to this theory, the tax would clearly violate 31 U.S.C. § 3124 and would, therefore, be unconstitutional under the borrowing clause of the United States Constitution. The trial court accepted this theory and concluded that the tax is an income tax. We disagree.

The trial court's conclusion on this issue is inconsistent with the legislative history of section 3124 and Reuben. In American Bank & Trust Co. v. Dallas County, 463 U.S. 855, 870-71, n. 13 (1983), the United States Supreme Court observed that the inability of states to include interest from federal obligations in an income tax was the primary reason for enacting tax legislation permitting the imposition on national banks of non-discriminatory franchise taxes based on corporate income. Thus, the exception for non-discriminatory franchise taxes measured by income appears to be an intentional elevation of form over substance in recognition of the fact that banks would otherwise operate totally tax free.

In Reuben, this court noted that 31 U.S.C. § 3124 was amended in 1959 so as to permit the inclusion of interest from federal obligations in the computation of a non-discriminatory franchise tax and reasoned that to conclude the tax imposed by section 290.02 was, in reality, an income tax would render the 1959 amendment "completely meaningless." See Reuben, 303 Minn. at 130, 226 N.W.2d at 615. The Reuben court's determination that the tax levied on the income from interest on govern-

ment obligations is a franchise tax is supported by this court's decision in Soo Line R.R. Co. v. Commissioner of Revenue, 377 N.W.2d 453 (Minn. 1985), where the court observed that "[t]he incident of the franchise taxed under the excise tax,[9] however, is the privilege of carrying on business, not the property of the franchise." Id. at 455 (emphasis and footnote added; citation omitted). The reasoning of the Reuben court is also supported by the United States Supreme Court's observations in American Bank & Trust. Accordingly, we reverse the trial court's conclusion that the bank tax is an income tax for purposes of section 3124 and conclude instead that it is a franchise tax. As a result, the next question is whether it is "non-discriminatory."

Our review of the relevant statutes convinces us that the tax in question is discriminatory. Banks doing business in the State of Minnesota during the relevant period were required to pay a tax measured by their net income. Minn. Stat. § 290.361, subd. 1. That tax was governed by the provisions of Minn. Stat. § 290.02. Id. Both Minn. Stat. § § 290.02 and 290.361 referred to an "excise" tax measured by taxable net income. Minn. Stat. § 290.08, subd. 8 (1984) (repealed 1987) exempted any interest earned on either United States or State of Minnesota obligations from gross income. That exclusion, however, was not applicable to "corporations taxable under section 290.02 or 290.361." Id. (emphasis added). Consequently, for banks doing business in the

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[9] An excise tax is a tax imposed on the performance of an act, the engaging in of an occupation, or the enjoyment of a privilege, including corporate privileges. In current usage, the term includes practically every internal revenue tax except the income tax. Black's Law Dictionary 506 (5th ed. 1979).

State of Minnesota, interest earned on federal obligations was included in the taxable net income figure used to compute their chapter 290 excise tax. Certain state bond enabling statues, however, overrode the above provisions of chapter 290 and exempted interest earned thereon from inclusion in income for the purpose of calculating chapter 290 taxes. See Minn. Stat. § 136.32 (1982) (amended 1983) ("SUB's"); Minn. Stat. § 474.12 (1982) (repealed 1983) (Municipal Industrial Development Bonds ("IDB's")).[10]

The trial court, in reliance on Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 398 (1983), concluded that, during the 1979 through 1983 calendar years, the bank tax was discriminatory because interest from certain State of Minnesota obligations was exempt.[11] Appellants concede that, at least as to IDB's and SUB's, the bank tax is discriminatory. Although we question the

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[10] The trial court also found that interest earned on obligations of the following State of Minnesota agencies was exempt from inclusion in the bank tax:

Minnesota Higher Education Coordinating Board Bonds
Minnesota Higher Education Facilities Authority Bonds
Metropolitan Transit Commission Bonds
Public Water and Sewer Bonds
Hospital District Bonds
Hospital Revenue Bonds
St. Cloud Transit Commission Bonds
Metropolitan Waste Control Commission Bonds
Housing Redevelopment Authority Bonds
Area Redevelopment Agency Bonds
Minnesota State Armory Commission Bonds
Solid Waste Management District Bonds

[11] In 1983, the Minnesota Legislature repealed the exemption provisions contained in numerous state obligation enabling statutes. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 614-25.

judgment of appellants in making this concession, the trial court's conclusion that the bank tax was discriminatory is affirmed as the law of this case.

II. The second issue presented by this appeal is whether the bank tax falls within a de minimis exception to section 3124. Appellants argue that the impact of the bank tax on the borrowing power of the United States government is de minimis and, therefore, the constitutional defects should be ignored. Appellants' de minimis defense is apparently based on dicta in Memphis Bank & Trust where, in a footnote, the Court stated:

> We cannot regard the impact of the discrimination as de minimis. According to the United States, which filed a brief as amicus curiae in support of reversal, if all 50 States enacted provisions comparable to the Tennessee bank tax, the United States would incur additional annual borrowing costs estimated at $280 million at an interest rate of 12%.

Id. at 398 n.8 (citation omitted).

In the present case, the trial court concluded that there is no de minimis defense and found that, even if there were such an exception, "[t]he economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense." We cannot say that the trial court's finding was clearly erroneous; thus, we conclude that the impact of the bank tax on federal borrowing was not de minimis. Accordingly, even assuming, arguendo, that there is a de minimis exception to section 3124, it is not applicable in the instant case.

III. Appellants argue that respondents should be estopped from asserting their claims that exemption of IDB's and SUB's

from the bank tax discriminated against federal obligations under the acceptance-of-benefits doctrine. In Gale v. Commissioner of Taxation, 228 Minn. 345, 37 N.W.2d 711 (1949), the taxpayer sought to invoke the provisions of a tax statute to secure the benefit of a tax computation and, at the same time, challenged the constitutionality of another provision of the same act. Id. at 352, 37 N.W.2d at 716. This court said "[H]e who assumes the validity of a statute by invoking its provisions to obtain a tax reduction may not attack its constitutionality." Id. (citing Byard v. Commissioner of Taxation, 209 Minn. 215, 296 N.W. 10 (1941).

Respondents do not dispute that they accepted the tax benefits of the exemption for interest on State of Minnesota obligations. Instead, respondents suggest that the acceptance-of-benefits doctrine of estoppel is no longer good law. In Wegan v. Lexington, 309 N.W.2d 273, 277 (Minn. 1981), this court did not reject the acceptance-of-benefits doctrine in tax cases like Gale and Byard. See Wegan at 277. We conclude, therefore, that, under the rule in Gale, respondents should be estopped from challenging the constitutionality of the bank tax. We do not, however, decide this case on that ground alone.

IV. Based on Minn. Stat. § 645.20 (1988), appellants ask this court to declare the language in the various state obligation enabling statues which exempt the interest earned thereon from taxation to be unconstitutional and sever it from the remaining portion of the statutes. This is a compelling argument. Minn. Stat. § 645.20 (1988) provides, in pertinent part, as follows:

> If any provision of a law is found to be unconstitutional and void, the remaining provisions of the law shall remain valid, unless the court finds the valid provisions

> of the law are so essentially and inseparably connected with, and so dependent upon, the void provisions that the court cannot presume the legislature would have enacted the remaining valid provisions without the void one * * * .

It is the exemption for interest earned on state obligations that makes the bank tax discriminatory and, therefore, unconstitutional. Moreover, since the legislature amended the statutes in question by deleting the challenged exemptions, this court can presume that the legislature would have enacted the remaining provisions without the void one.

Indeed, when the legislature adopted the bank franchise tax in 1941, it did not exempt the disputed state interest revenue. See Act of Feb. 21, 1941, ch. 18, § 4, 1941 Minn. Laws 23, 24. The provisions exempting interest of certain state obligations were not enacted until 1957 and 1967. Act of Apr. 24, 1957, ch. 603, § 2, 1957 Minn. Laws 753 (SUB's); Act of May 4, 1967, ch. 297, § 12, 1967 Minn. Laws 456, 465 (IDB's). Can it be said that these later additions invalidated the entire original act? We think not. Since the original act was valid, the subsequent amendments, if unconstitutional, may be severed from the original act which remains valid.

In Johnson Bros. Wholesale Liquor Co. v. Commissioner of Revenue, 402 N.W.2d 791 (Minn. 1987), this court affirmed the tax court's use of a similar remedy in addressing a discriminatory tax on wine sales. See id. at 793. The Johnson Bros. court also observed that the United States Supreme Court has recognized that a withdrawal of benefits from the favored class is an acceptable remedy for unconstitutional discrimination. Id. (citing Iowa-Des Moines Nat'l Bank v. Bennett, 284 U.S. 239, 247 (1931). In the

case at bar, the trial court simply did not apply section 645.20. Section 645.20 indicates, however, subject to certain qualifications which are not applicable in this case, that if any provision of a law is found to be unconstitutional, severance is mandatory and the remaining provisions are valid. Accordingly, this court concludes that the trial court abused its discretion in refusing to apply section 645.20 and is, therefore, reversed.

Respondents seek to avoid such a result by emphasizing that the Minnesota Department of Revenue has stipulated that it will not collect Minnesota bank taxes on interest earned from SUB's issued pursuant to Minn. Stat. § 136.31-38 or from IDB's issued prior to July 1, 1979. This stipulation arguably distinguishes the present case from Johnson Bros. wherein the Revenue Department actually collected the back taxes from the unlawfully favored wineries. See Johnson Bros. at 792.

Respondents cite Allegheny Pittsburgh Coal Co. v. County Commissioner of Webster County, 488 U.S. 336, 109 S. Ct. 633 (1989), as authority for the proposition that discriminatory taxation is not cured by raising a tax on someone else. However, they fail to point out that Allegheny was an equal protection property tax case presenting significant valuation problems and did not involve a statutory mandate such as Minn. Stat. § 645.20. Respondents also cite Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 267-81 n.7 (1984), but again fail to discuss significant differences between that case and this one. In Bacchus, the State of Hawaii imposed a 20% excise tax on wholesale liquor, but exempted certain locally manufactured alcoholic beverages. Wholesalers of nonexempt beverages challenged the tax as violative of the commerce clause. In the footnote cited by respondents, the United States Supreme

Court noted that the severance issue was not presented to the Supreme Court of Hawaii in the case below and merely commented in passing that "severance" would not relieve the harm inflicted. Bacchus, 468 U.S. at 267-68 n.7.

The recent decision in McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, ___ U.S. ___, 58 U.S.L.W. 4665 (June 4, 1990), makes clear that a state may cure the invalidity of a discriminatory tax by assessing and collecting back taxes from those who benefited from the discrimination. Id. at 4671. Although the Court concluded in McKesson that, in commerce clause cases, a state that selects this remedy must actually impose a retroactive tax, that conclusion was premised on the fact that actual collection is necessary in order to cure the comparative economic disadvantage caused by the discriminatory tax. See id. at 4671-72. The present case is distinguishable from McKesson because there is no need to remedy any comparative economic disadvantage. Accordingly, we hold that severing the invalid exemptions renders the bank excise tax non-discriminatory and thereby satisfies the due process requirement of a fully adequate post-deprivation remedy.

More fundamentally, even if actually collecting the tax is a prerequisite to curing the constitutional infirmity of the tax in question, respondents do not explain where the Revenue Department gets the authority to limit this court's power to fashion an appropriate remedy for an unconstitutional tax. See Amundson v. Cloverleaf Memorial Park Ass'n, 221 Minn. 353, 358, 22 N.W.2d 170, 172 (1946) (suggesting that mistake and lack of authority are

grounds for relieving a party from a stipulation).[12] Were it not for our conclusion that the Memphis Bank case established a new principle of law that was not clearly foreshadowed, we would order the Revenue Department to assess and collect the tax attributable to the state obligation interest income. We believe that ordering actual collection of the tax in this case would unfairly penalize both parties for failing to foresee the change in the law brought about in Memphis Bank. Consequently, we reject the respondents' contention that actual imposition of back taxes is necessary in this case.

An additional reason for reversing the trial court is that it inappropriately applied the Memphis decision retroactively. The three factors governing non-retroactive application of judicial decisions were set forth in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), as follows:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, it has been stressed that "we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." Finally, we have weighed the inequity imposed by

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[12] When confronted with similar options, the Nebraska Supreme Court also chose to sever the unconstitutional exemptions. State ex rel. Douglas v. Karnes, 216 Neb. 750, 760, 346 N.W.2d 231, 236 (1984).

> retrospective application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

Id. at 106-07 (citations omitted). Applying these factors to the present case, we conclude that the decision in Memphis should be given prospective application only.

First, since the legislature passed the first state obligation interest exemption to the bank franchise tax in 1957, more that 20 years elapsed before these taxpayers questioned the validity of this exemption. Yet, respondents argue that the Memphis case should be applied retroactively because it was not, they aver, a case deciding an issue of first impression whose resolution was not clearly foreshadowed. The fact that this case was not brought until immediately after the Memphis case was decided, however, completely eviscerates the argument that the Memphis decision was clearly foreshadowed.

Second, the primary purpose of section 3124 is to protect the borrowing power of the United States Government. See Memphis Bank, 459 U.S. at 396 (referring to the congressional intent to prevent taxes which diminish the value of United States obligations). Respondents have not explained how the borrowing power of the United States will be protected by allowing them to receive multimillion dollar refunds. It seems to us that the purpose of promoting investments in United States obligations and protecting the borrowing power of the United States Government will be just as adequately advanced by prospective application as it will by retroactive application. This is especially true given that, soon

after Memphis Bank was decided, the Minnesota Legislature met and repealed the disputed exemptions for Minnesota obligations. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 613-25.

Finally, in weighing the equities involved in this case, it is obvious that retroactive application of the Memphis Bank decision would cause a hardship to the State of Minnesota. The excise taxes in question have long since been spent by the state in providing, among other things, regulatory and other public services for all taxpayers, including the respondent banks. See First Nat'l. Bank of Fredericksburg v. Commonwealth, 553 A.2d 937, 947 (Pa. 1989) (Larsen, J., dissenting). By comparison, no equivalent hardship results to the banks by a prospective application of the decision in Memphis Bank. On the contrary, respondents' taxes were actually reduced during the years the state obligation interest exemptions were mistakenly in effect. If the Memphis Bank decision is applied retroactively, respondent banks will have operated essentially tax-free during the period in question and would receive a refund of taxes that were, in effect, paid by others. Such a result would provide respondent banks with an undeserved windfall. As corporate citizens, these banks should not be allowed to enjoy the benefits of the privilege of doing business in the State of Minnesota without paying taxes.

In construing the very same issue, the Oklahoma Supreme Court in First of McAlester Corp. v. Oklahoma Tax Commission, 709 P.2d 1026 (Okla. 1985), also decided that Memphis Bank should be applied prospectively only. The McAlester court stated:

> It is arguable that previous case law foreshadowed the Memphis Bank pronouncement. It is equally persuasive that the type of bank tax in question might reasonably

> have been assumed to be constitutional based on the longstanding and widespread practice of various states to which the United States Supreme Court had not specifically spoken.
>
> * * *
>
> Although the Memphis Bank case does not involve a reversal of a United States Supreme Court decision as in Texas Company, it does decide a new principle of law.
>
> * * *
>
> Although the new principle of law established in Memphis Bank might be characterized as merely a progression from former decisions, it was not foreseen by the Commission, nor by the Oklahoma Legislature.

Id. at 1034-36. We believe that the position of the Oklahoma court is sound. See also American Trucking Ass'ns, Inc. v. Smith, ___ U.S. ___, 58 U.S.L.W. 4704 (June 4, 1990) (applying the Chevron Oil test in upholding the Arkansas Supreme Court's prospective application of a United States Supreme Court decision which established a new principle of law).

For all of the above reasons, the trial court is reversed in its finding that the Minnesota bank franchise tax is an income tax and in the remedies it imposed. Respondents' request for refunds is denied in all respects.[13]

KELLEY, Justice (concurring specially)

I concur in the result; although I do not join that part of the

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[13] Because of our other rulings in this case, we need not decide the issue of whether the trial court erred in refusing to reduce the ordered tax refunds by amounts allegedly allocable to the production of the interest income.

opinion that purports to hold that the banks should be estopped from challenging the constitutionality of the bank tax.

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF RAMSEY SECOND JUDICIAL DISTRICT

---------- CASE TYPE: OTHER CIVIL

Cambridge State Bank, et al.,
Plaintiffs,

vs. File No. 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,
Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),
Plaintiff,

vs. File No. 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,
Defendants.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER ON PHASE I LIABILITY

These consolidated cases came on for trial before the Honorable Harold W. Schultz, Judge of the District Court, on October 31, November 5, 6, 7, 12, 13, 14, and 17, 1986, in Courtroom

1315, Ramsey County Courthouse, St. Paul, Minnesota.

CHRISTOPHER J. DIETZEN, ESQ., and ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

JAMES P. MC CARTHY, ESQ., and LAURENCE R. WALDOCH, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

ROBERT L. SCHNELL, JR., ESQ., of the law firm of FAEGRE & BENSON, 2300 Multifoods Tower, Minneapolis, Minnesota 55402-3694, and WALTER A PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and JAMES W. NEHER, ESQ., Special Assistant Attorney General, Second Floor, Centennial Office Building, St. Paul, Minnesota 55145, appeared representing the Defendants.

Court File No. 469151 was commenced by over 170 banks who are seeking tax refunds from the State of Minnesota for alleged over-payment of taxes in the years 1979 to 1983. Court File No. 469547 involves a similar claim on behalf of the Norwest Bank Duluth for the year 1979. The Court is informed that there are other cases pending in other jurisdictions within the State of Minnesota involving the same issues.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of liability and

damages. These Findings and Conclusions concern the liability portion of the trial.

By further agreement of counsel and order of this Court the matter was presented on a test case basis. Evidence was presented by four banks for the 1979 tax year. The four banks were: The Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The parties agreed that the conclusion of the Court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks.

Prior to the commencement of trial both parties submitted motions in limine. The plaintiffs moved for summary judgment on liability or, in the alternative, for an order to exclude certain evidence as irrelevant. The defendants moved for leave to amend their answers to assert an additional affirmative defense and for dismissal of the plaintiffs' complaints. After consideration, this Court granted the defendants' motion for leave to amend and denied all other pretrial motions. At the same time, this Court ruled that the defendants had the burden of establishing as affirmative defenses their claim with respect to the so-called issues of "comparability" and "de minimis impact."

At the inception of the trial the parties submitted a Stipulation of Facts (Plaintiffs' Exhibit 1) and attached exhibits (Plaintiffs' Exhibit 2) which were received into evidence. Based on those submissions, plaintiffs rested.

Thereafter, defendants presented their testimony on the affirmative defenses mentioned above. Defendants' witnesses were Mr. Delos Steenson and Dr. Timothy J. Nantell. Plaintiffs presented rebuttal testimony from Dr. Sung Won Sohn, Dr. John H.

Kareken, and Dr. David Wyss. After defendants' rebuttal testimony from Dr. Nantell, the trial concluded.

Having heard the testimony presented, and upon all of the evidence, files, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Order.

INITIAL FINDINGS

1. Several of the Findings of Fact that follow are summaries of facts detailed in the Stipulation of Facts. (See Plaintiffs' Exhibits 1 and 2.) All facts stipulated to in those two exhibits are explicitly found to be facts by this Court, although they will not be recited individually here in the interests of readability and brevity.

2. Each of the plaintiff banks paid taxes to the State of Minnesota for the tax year 1979 pursuant to Minn. Stat. § 290.361. (Stipulation of Facts, paragraph 1.)

3. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States Government. These obligations included U.S. Treasury Notes, U.S. Treasury Bills, U.S. Treasury Bonds, and obligations from various federal agencies including:

Federal Land Bank
Federal Home Loan Bank
Federal Farm Credit Bonds
Federal Credit Savings Bank
Farmers Home Administration Notes
World Bank Bonds
Bank for Cooperatives
Federal Home Loan Banks

Federal National Mortgage Association

Government National Mortgage Association

(Stipulation of Facts, paragraphs 3 and 5.)

4. Pursuant to statute, the measure of the tax paid by these banks did not include interest income earned by the banks on State University Board Bonds (SUB's) and Industrial Development Bonds (IDB's) issued by municipalities in the State of Minnesota. (Stipulation of Facts, paragraph 4.)

5. Also exempted from inclusion in the measure of the state bank taxes paid by the plaintiffs was interest earned on the following obligations of agencies of the State of Minnesota:

Minnesota Higher Education Coordinating Board Bonds

Minnesota Higher Education Facilities Authority Bonds

Metropolitan Transit Commission Bonds

Public Water and Sewer Bonds

Hospital District Bonds

Hospital Revenue Bonds

St. Cloud Transit Commission Bonds

Metropolitan Waste Control Commission Bonds

Housing Redevelopment Authority Bonds

Area Redevelopment Agency Bonds

Minnesota State Armory Commission Bonds

Solid Waste Management District Bonds

6. The Plaintiffs filed timely protective claims for refunds for the tax year 1979. (Stipulation of Facts, paragraph 2.)

7. The plaintiffs in both of these consolidated actions timely filed these actions for refunds.

8. There is no economic difference between the Minnesota bank tax imposed by Minn. Stat. § 290.361, which is labelled

an "excise" tax measured by net income, and a tax that is imposed directly on net income such as the federal income tax.

INITIAL CONCLUSIONS OF LAW

9. During the 1979 through 1983 calendar years, the imposition of the Minnesota bank tax, pursuant to Minn. Stat. § 290.361, on interest received or accrued from obligations of the United States and its agencies was discriminatory because interest received or accrued from certain obligations of the State of Minnesota, its political subdivisions, and its instrumentalities was exempt from the tax. Cf. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

10. Inasmuch as the Minnesota bank tax was discriminatory during the 1979 through 1983 calendar years, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and under the Supremacy and Borrowing Clauses of the United States Constitution. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

11. The Minnesota bank tax imposed by Minn. Stat. § 290.361, although labelled an "excise" tax, is a direct tax on net income for purposes of federal statutory and constitutional law. Cf. Complete Auto Transit v. Brady, 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977) (the constitutionality of a state tax depends upon its actual economic consequences, not upon the label given to it by the state).

12. Inasmuch as the Minnesota bank tax is an income tax rather than a franchise tax, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and

under the Supremacy and Borrowing Clauses of the United States Constitution during the 1979 through 1983 calendar years. Cf. Federal Products Corp. v. Norberg, 429 A.2d 447 (R.I. 1981).

13. Defendants are liable to plaintiffs for refunds attributable to Minnesota bank taxes paid with respect to interest received or accrued on obligations of the United States and its agencies in amounts to be determined in a separate trials on the issue of damages.

BACKGROUND TO ADDITIONAL FINDINGS OF FACT AND CONCLUSION OF LAW

The State of Minnesota acknowledges that Minnesota's bank tax treats interest earned on certain state obligations more favorably than it does interest earned on federal obligations. Nevertheless, the state argues that the tax is not unconstitutional. It presents three arguments in support of its position. The first is that the state obligations given preferential treatment under the state tax are not sufficiently "comparable" to federal obligations to establish discrimination. Second, the state argues that the preferential treatment of certain state obligations has little or no effect on the cost of borrowing by the federal government and, consequently, the preferential treatment is of no legal consequence. Finally, the state argues that the plaintiff banks are estopped from making these claims because they received the benefits of the provision they now claim to be unconstitutional. These defenses are referred to as the "comparability," "de minimis impact," and "estoppel" defenses.

As mentioned previously the plaintiffs moved at the inception of the trial for a ruling as a matter of law that none of these three defenses was legally cognizable. The Court denied those motions

prior to trial and allowed the defendant to present testimony in support of these defenses. The Court felt that this case would be more appropriately structured for review by an appellate tribunal if these three defenses would receive a full and complete hearing. Based on all of the evidence presented by both sides, the Court makes the following additional Findings of Fact and Conclusions of Law.

ADDITIONAL FINDINGS OF FACTS CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

14. The obligations of the federal government and the exempted state obligations (See Findings 3 and 4 above) are similar in that they all are:

(a) Debt instruments (Tr. Vol. I at 48.)

(b) With fixed periods of repayment. Id.

(c) With fixed interest rates. Id. at 47

(d) With the payor of the obligation identified in the instrument. Id.

(e) With the principal amount of the debt fixed. Id.

(f) With the right in the bearer to resell them. Id. at 47.

(g) Issued by governmental agencies. Id.

(h) Issued pursuant to and in compliance with specific statutory authorization. Id.

(i) And, in the case of Federal Farm Credit Obligation and IDB's, both are used to provide low cost financing for statutorily approved

purposes and both depend on repayment of debts by the beneficiary of the low cost financing. (Tr. Vol. I at 91-92.)

15. State obligations, including some IDB's, compete with some treasury obligations for investor dollars. (Tr. Vol. I at 46-47.)

16. Investors in debt instruments compare many different characteristics of those instruments in making their investment choices. (Tr. Vol. I at 46 and 48.) Among those are the characteristics of risk and liquidity. Id.

17. Obligations of the United States Treasury are generally considered to be of low risk and high liquidity. (See Defendants' Exhibit 1.)

18. Some IDB's are likewise considered to be of low risk and high liquidity. Indeed, some IDB's are perceived as being less risky and as liquid as certain of the non-treasury obligations of the federal government. (Tr. Vol. I at 63-66 and 70.)

19. Differences in risk, as well as in other characteristics, tend to be reflected in the prices of a bond. (Tr. Vol. I at 61.) The issuers of bonds which may be perceived as risky tend to offer higher interest rates than do issuers of bonds of less risk and greater liquidity. Id. This price adjustment allows for competitive comparisons of obligations with different characteristics.

20. To the extent that the obligations of the State of Tennessee and its political subdivisions are comparable to federal obligations, Minnesota Obligations are likewise comparable. (See Plaintiffs' Exhibit 2, attachments N and P.)

B. "De Minimis Impact."

21. The exemption granted to certain state obligations under the Minnesota Bank Tax caused the interest rate for those obligations to be lower than they would have been without the exemption. [Plaintiffs' Exhibit 6, at 8 (Nantell), Tr. Vol. II at 10 (Sohn), Tr. Vol. III at 153 (Kareken).] Investors who are interested in after tax return can get a competitive return on bonds bearing lower interest if they are also granted a tax exemption on the interest earned from those bonds. [Tr. Vol. II at 14, 30-31 (Sohn), Tr. Vol. IV at 7 (Kareken), Tr. Vol. V at 37-38 (Wyss).]

22. Because the tax exemption allows these obligations to carry lower interest rates, the demand for this type of credit among borrowers was higher than it would have been without the exemption. Id.

23. This phenomenon alone increases the interest rates on certain federal obligations. [Tr. Vol. IV at 17-19 (Kareken), Tr. Vol. V at 16-18 (Wyss).]

24. Moreover, the evidence established that as a result of lower interest rates on the tax exempt bonds there was a net increase in the amount of borrowing over that which would have existed without the exemption. [Tr. Vol. II at 17 (Sohn) and, e.g., Tr. Vol. V at 31 (Wyss).] This is pictorially represented on the supply/demand curves introduced at trial. (See e.g. Plaintiffs' Exhibit 7.)

25. The net increase in borrowing caused by the tax exemptions at issue here increased the competition among all borrowers, raising the cost to all borrowers, including the federal government. [Tr. Vol. II at 17 (Sohn), Tr. Vol. V at 33-35 (Wyss).]

26. Credible testimony established that the tax exemption

under consideration here resulted in additional credit demands for IDB's of approximately thirty percent (30%) for general development bonds and up to eighty percent (80%) for pollution control and nonprofit IDB's. (See Plaintiffs' Exhibit 17 at 2-4.) On a national basis, the thirty percent (30%) additionality for industrial bonds translates to an additional $6 billion of credit demand annually. [Tr. Vol. V at 33-34 (Wyss).] The result of such an addition to the competition for credit on the federal government would be to increase federal borrowing costs approximately $1.75 billion. [Tr. Vol. V at 35 (Wyss).]

27. The preferential treatment by the state of various of its obligations burdened the holders of federal obligations. The result was that the cost of borrowing by the federal government was higher than it would have been without the preferential treatment. [Tr. Vol. II at 12 and 17 (Sohn), Tr. Vol. III at 159 (Kareken), and Tr. Vol. V at 37-44 (Wyss).]

C. "ESTOPPEL."

28. The plaintiffs, by availing themselves of the tax exemption granted by the state on certain of its obligations, did not claim any benefits under the portion of the tax code asserted by plaintiffs to have been unconstitutional.

ADDITIONAL CONCLUSIONS OF LAW CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

29. This Court concludes as a matter of law that the state obligations which received preferential treatment by the State of Minnesota are, for the purposes of the constitutional and statutory

analysis required under Memphis Bank, otherwise comparable to federal obligations.

B. "DE MINIMIS IMPACT"

30. This court further concludes that preferential treatment of state obligations is, on its face, discrimination. It would be of no legal significance had the state succeeded in establishing that the economic incident of that discrimination was minute or even nonexistent. To protect the constitutional principle at issue, it is enough that there be facial discrimination.

31. Moreover, the evidence clearly established that the discriminatory taxing scheme used by the State of Minnesota, if likewise used by all fifty states, would cause the interest rates paid by the federal government in support of its debt to rise. The economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense.

C. "The Estoppel Defense."

32. The plaintiffs are not estopped from bringing this claim for refund. The theory of estoppel upon which the defendant relies is no longer the law in the State of Minnesota. See Wegan v. Village of Lexington, 309 N.W.2d 273, 277 (Minn. 1981); Haugen v. Town of Walthen, 292 N.W.2d 373 (Minn. 1980); Werner v. Olmstead County, 290 N.W.2d 444 (Minn. 1980). Moreover, factually the theory is simply inapplicable since plaintiffs did not benefit from the provisions they claim are unconstitutional.

33. All of the foregoing Findings of Fact may, if deemed

more appropriate, be considered Conclusions of Law and vice versa.

* * *

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that the defendants are adjudged liable to the plaintiffs for tax refunds in amounts to be determined in Phase II of this proceeding.

Dated at St. Paul, Minnesota, this 20th day of May, 1987.

S/Harold W. Schultz

HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT COURT

MEMORANDUM

This Court feels that an extensive memorandum quoting cases, statutes, etc., is unnecessary. The attorneys involved in this case did an exceptionally able job of preparing and presenting this case.

First of all, counsel had stipulated as to certain facts, had taken depositions, and had briefed the various issues to a point where the trial went exceptionally smooth.

Counsel presented to the Court motions which, as far as the plaintiffs were concerned, would have disposed of the case much in the manner of a summary judgment. While the arguments on the part of plaintiffs were reasonably persuasive, the Court felt that there was a danger that if the case were disposed of on that basis it could be suggested that ample opportunity to raise factual issues and defenses had not been given to the defendants. Therefore, the

Court denied the motions for summary judgment and granted the defendants' motions for a hearing on the various items that defendants felt were proper defenses to plaintiffs' claims. A substantial amount of time was given to the defendants to present the testimony of experts dealing with the questions of comparability and de minimis impact.

The argument with respect to the estoppel agreement was a legal argument not requiring any testimony.

The testimony of the expert witnesses was produced and heard by the Court in an expeditious manner. However, a complete hearing was given to the defendants with respect to these issues. Unfortunately, neither the testimony of the witnesses nor the law provide any comfort to the position taken by the defendants. This Court was convinced beyond any doubt that the plaintiffs must prevail in this matter.

A careful reading of the Supreme Court with respect to the Memphis Bank and Trust Company case leads the Court to the conclusion that the Minnesota and Tennessee situations for all practical purposes are identical. The burden of proof which the state had with respect to the comparability defense was not met and the Court has concluded that on that defense the state does not prevail.

The Court further adopts the position taken by plaintiffs that the important aspect for the Court in this matter was discrimination rather than impact. It goes without saying that the Court found discrimination and sufficient impact. The state did not establish that the effect of its discriminatory tax had only a de minimis impact.

It should be noted that counsel have suggested that the policy

questions and the complexity of the issues herein dictate that this matter be reviewed by the appellate system in the State of Minnesota and possibly even in the federal courts. For that reason the Court feels that the record provides an ample basis for any appellate review.

The Court feels that it would be redundant to restate the facts as set out in the Findings of Fact, Conclusions of Law, and Order. This matter has been well tried, carefully considered, and the conclusion as stated in the Court's order is, in the opinion of the Court, the only conclusion possible based on the facts and the law.

S/Schultz, J.

Schultz, J.

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et al.,
Plaintiffs,

vs. File No. C1 84 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,
Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),
Plaintiff,

vs. File No. C4 84 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,
Defendants.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER ON PHASE II - REFUNDS

These consolidated cases came on for trial before The Honorable Harold W. Schultz, Judge of the District Court, on February 27 and 28, 1989, in Courtroom 1531, Ramsey County Courthouse, St. Paul, Minnesota.

ROBERT L. SCHNELL, JR., ESQ., of the law firm FAEGRE & BENSON, 2200 Norwest Center, Minneapolis, Minnesota 55402, and WALTER A. PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS L. FABEL, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and BARRY GRELLER, ESQ., Special Assistant Attorney General, Tax Litigation Division, 10 River Park Plaza, Mail Station 0600, St. Paul, Minnesota 55146, appeared representing the Defendants.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of liability and damages. In Phase I of the case, the Court held that the Minnesota bank tax (Minn. Stat. §290.361) unlawfully discriminated against Federal obligations during the period 1979 through 1983 in violation of Federal law, 31 U.S.C. §742. The Court also held that the Minnesota bank tax, although labelled an "excise" tax, was an income tax for purposes of Federal statutory and constitutional law, and that this also made the Minnesota bank tax unlawful under 31 U.S.C. §742. The Court held that Defendants were liable to Plaintiffs for refunds in amounts to be determined at Phase II of

the trial. These Findings and Conclusions concern Phase II, the refund portion of the trial.

By further agreement of counsel and order of this Court, the matter was presented on a test case basis. Evidence was presented by four banks (the "Test Banks") for the 1979 tax year. The four banks were: Cambridge State Bank ("Cambridge"), Midway National Bank of St. Paul ("Midway"), First Security State Bank of Sleepy Eye ("Sleepy Eye"), and Norwest Bank Duluth ("Norwest"). The parties agreed that the conclusion of the Court on the refund phase would be conclusive as to all tax years at issue and all of the Plaintiff banks.

Prior to the commencement of trial, the parties submitted motions in limine. The Plaintiffs moved for summary judgment on certain issues or, in the alternative, for an order to exclude certain evidence as irrelevant. The Defendants also submitted motions for summary judgment. The Court heard arguments regarding all motions on January 20, 1989.

Plaintiffs' first motion requested partial summary judgment dismissing Defendants' contention that discrimination against Federal obligations should be cured by invalidating all statutes favoring state bonds. Defendants' second motion requested summary judgment in favor of invalidating such statutes, which would result in the removal of the tax-exempt status of such bonds. At the commencement of trial, the Court granted Plaintiffs' first motion and denied Defendants' second motion. A Conclusion of Law to this effect is included below in paragraph 31. The Court held that discrimination against Federal obligations would not be cured by retroactively invalidating the tax-exempt status of state bonds because, in actual fact, such bonds were tax-exempt in 1979

and the Department of Revenue has not collected (and by stipulation will not collect) tax on such bonds. Thus, granting Defendants' second motion would, in substance and effect, uphold the unconstitutional discrimination against Federal obligations and deny Plaintiffs a remedy.

Plaintiffs' second motion requested partial summary judgment dismissing the contention of Defendants' that Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), be applied on a prospective-only basis. In the alternative, Plaintiffs' moved for the exclusion of the testimony of Mr. Oja Ena with respect to the prospectivity issue. This latter motion was denied, and Mr. Ena's testimony was received. Defendants' third motion requested summary judgment that the Memphis Bank case should be applied on a prospective-only basis. Defendants also moved in their first motion for summary judgment that the Court's ruling holding the Minnesota bank to be an income tax should be applied on a prospective-only basis. Having received the testimony of Mr. Ena on these issues, the Court hereby denies all motions on prospectivity issues, which instead will be considered upon all of the evidence received.

Plaintiffs' third motion asked for summary judgment that their interest deductions should be allowed as a matter of law pursuant to Minn. Stat. §290.09, subd. 3. Defendants filed a cross-motion for summary judgment on this issue. Plaintiffs, as an alternative, requested that the testimony of Mr. Larry D. Fredricks, a witness for Defendants, be excluded. The Court denied this latter motion and received the testimony of Mr. Fredricks. The Court also received the testimony of Plaintiffs' witnesses, Mr. Philip D. Rolle and Mr. Lloyd A. Amundson, on this issue. Inasmuch as both

parties have introduced testimony on the issue of whether interest deductions should be disallowed, the Court hereby denies all motions on this issue, which will instead be considered upon all of the evidence received.

At the inception of the trial of Phase II, the parties submitted a Statement of Position and Stipulation of Facts (Phase II) and attached exhibits (Plaintiffs' Exhibit 21) which were received into evidence. Thereafter, the Plaintiffs called as witnesses Mr. Rolle and Mr. Amundson, who testified regarding the investment activities, operations and expenses of banks. Defendants called Mr. Fredricks, who testified regarding the same issues, and Mr. Ena, who testified regarding the financial impact to the State of Minnesota in the event refunds are awarded to all taxpayers who have relied on the Memphis Bank case in filing refund claims. The trial then concluded.

Having heard the testimony presented, and upon all of the evidence, files, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Orders.

FINDINGS OF FACT

1. Several of the findings of fact that follow are summaries of facts detailed in the Statement of Position and Stipulation of Facts (Phase II) dated February 27, 1989 (the "Phase II Stipulation"), and exhibits thereto (See Plaintiffs' Exhibit 21). All of the facts stipulated to in the Phase II Stipulation are explicitly found to be facts by this Court, and are incorporated by reference, although they will not be recited individually here.

2. The Test Banks paid Minnesota bank taxes for 1979 in the following amounts: Northwest, $229,295 (Phase II Stipula-

tion, ¶ 28); Sleepy Eye, $36,378.36 (Phase II Stipulation, ¶ 33); Cambridge, $23,933 (Phase II Stipulation, ¶ 38); Midway, $293,840 (Phase II Stipulation, ¶ 43).

3. The items of income, deduction and credit reported by each Test Bank on its Minnesota bank tax return for 1979 were accurate in amount. Such items were also properly reported for Minnesota bank tax purposes, except that (a) each Test Bank reported as taxable income interest earned on Federal obligations, which was held exempt from tax in Phase I of this case, and (b) because such interest was held to be exempt, certain deductions previously allowable became disallowable, as hereinafter described. (Phase II Stipulation, ¶'s 30, 35, 40 and 45.)

4. The Test Banks earned interest on Federal obligations in 1979 in the following amounts: Norwest, $1,599,288 (Phase II Stipulation, ¶ 30); Sleepy Eye, $348,577 (Phase II Stipulation, ¶ 35); Cambridge, $612,697 (Phase II Stipulation, ¶ 40); Midway, $393,125 (Phase II Stipulation, ¶ 45).

5. The Test Banks incurred investment operating expenses in 1979, which consisted of operating expenses associated with Test Bank investment functions insofar as they were allocable to Federal obligations. Investment operating expenses included salaries and fringe benefits paid during the 1979 taxable year to employees whose duties included investing in Federal obligations and monitoring such investments, and certain other expenses relating thereto, including: expenses for management fees, office supplies, postage, telephone, data processing and occupancy, as well as depreciation on furniture and equipment used by personnel performing the investment function. (Phase II Stipulation, ¶ 10.C.)

6. The Test Banks incurred investment operating

expenses in 1979 in the following amounts: Norwest, $23,744; Sleepy Eye, $7,395; Cambridge, $12,318; and Midway, $5,009. (Phase II Stipulation, ¶ 10.D.) The Test Banks deducted such investment operating expenses in computing their respective liability for Minnesota bank tax.

7. There was a direct relationship between investment operating expenses and investment transactions. As the number of investment transactions increased or decreased, investment operating expenses increased or decreased. The reason for this is that there was a tie-in between investment operating expenses, which represent the cost of actually making investments, and investment transactions. (Tr. Vol. I at 63-66 [Rolle].)

8. Investment operating expenses incurred and deducted by the Test Banks were connected with or allocable against interest earned on Federal obligations. (Phase II Stipulation, ¶ 10.B; Tr. Vol. I at 63 [Rolle]; Tr. Vol. I at 176-180 [Amundson].)

9. Banks have a legal obligation under their charters to accept deposits. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I. at 187-88 [Amundson].) Banks can indirectly affect the amount of funds deposited by customers by setting interest rates paid on deposits and by advertising. However, banks cannot control the amount of deposits. (Tr. Vol. I at 67-72 and 115 [Rolle].)

10. Banks have a legal obligation under their charters and the Community Reinvestment Act to make loans. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I at 187-188 [Amundson].) Banks can indirectly affect the demand for loans by setting interest rates charged on loans and by advertising. However, banks cannot control the demand for loans by credit-worthy borrowers. (Tr. Vol. I at 72-76 and 115-116 [Rolle].)

11. If a bank does not have sufficient demand for loans, it may attempt to discourage a customer from depositing funds by suggesting that the customer purchase a Federal obligation, which can be sold to the customer by the bank. (Tr. Vol. I at 87-88 [Rolle].)

12. If a bank has deposits in excess of loans, because of an insufficiency in loan demand, the bank may "warehouse" its excess funds. In other words, it may invest its excess funds until an opportunity to lend the funds arises. Banks sometimes "warehouse" excess funds by purchasing Federal obligations. (Tr. Vol. I at 76-79 and 116 [Rolle]; Tr. Vol. I at 191-192 [Amundson].)

13. Banks do not accept deposits for the purpose of warehousing funds. (Tr. Vol. I at 129 [Rolle]; Tr. Vol. I at 192 [Amundson].)

14. Banks sometimes use Federal obligations to provide liquidity. (Tr. Vol. I at 138-139 [Rolle]; Tr. Vol. I at 188 [Amundson].) However, they are not obligated to use Federal obligations to provide liquidity and commonly use other kinds of securities for this purpose. (Tr. Vol. I at 139-140 [Rolle].)

15. Banks do not accept deposits for the purpose of creating liquidity through the purchase of Federal obligations. (Tr. Vol. I at 189 [Amundson].)

16. Banks sometimes use Federal obligations to meet pledging requirements if a state or local government deposits funds in excess of $100,000. (Tr. Vol. I at 189-190 [Amundson].)

17. Banks do not accept deposits requiring pledged assets for the purpose of purchasing Federal obligations. (Tr. Vol. I at 190 [Amundson].)

18. Each of the Test Banks incurred (and deducted for

Minnesota bank tax purposes) cost-of-money operating expenses in 1979. Cost-of-money operating expenses included salaries and fringe benefits paid to employees engaged in the fund-providing functions of a bank (i.e., those functions by which deposits and other funds are brought into a bank), including bank tellers, employees in checking operations, and employees engaged in acquiring equity capital and funds through long-term debt. Cost-of-money operating expenses also included expenses for office supplies, postage, telephone, advertising, travel, data processing and equipment and certain other expenses, all to the extent allocable to fund-providing functions. (Phase II Stipulation, ¶ 11.A.)

19. There was no relationship between cost-of-money operating expenses of the Test Banks and interest they earned on Federal obligations. For example, cost-of-money operating expenses of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 79-83 and 116-117 [Rolle]; Tr. Vol. I at 182-185 [Amundson].)

20. Cost-of-money operating expenses incurred and deducted by the Test Banks were not connected with or allocable against interest earned on Federal obligations. (Tr. Vol. I at 60-61 [Rolle]; Tr. Vol. I at 182 and 198 [Amundson].)

21. Each of the Test Banks incurred and deducted interest expense in 1979. (Phase II Stipulation, ¶'s 12-15.)

22. With the exception of interest paid by Norwest and Cambridge on capital notes, all interest deducted by the Test Banks

was paid or accrued on short-term borrowings incurred by the Test Banks in the ordinary course of their banking business including: savings accounts, savings certificates, certificates of deposit, Federal funds purchased, repurchase agreements and Federal Reserve Bank borrowings. (Phase II Stipulation, ¶ 21.)

23. The borrowings described in paragraph 22 were incurred for the purpose of making loans. (Tr. Vol. I at 104 [Rolle]; Tr. Vol. I at 206 [Amundson].)

24. Norwest and Cambridge incurred interest expense on capital notes in 1979. The capital notes were issued for the purpose of increasing their capital and expanding their capacity to make loans. (Phase II Stipulation, ¶ 23.)

25. There was no direct connection between indebtedness incurred by a Test Bank and investments by a Test Bank in Federal obligations. (Phase II Stipulation, ¶ 24.)

26. There was no relationship between interest expense paid or accrued by the Test Banks and interest income earned by the Test Banks on Federal obligations. For example, interest expense of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 83-86 [Rolle]; Tr. Vol. I at 186 [Amundson].)

27. The Test Banks did not incur or continue any indebtedness for the purpose of purchasing or carrying Federal obligations. (Tr. Vol. I at 62 [Rolle]; Tr. Vol. I at 186 [Amundson].)

28. The amount of refunds payable by the State of Minnesota to all taxpayers having claims similar to the Test Banks

is speculative and has not been established.

29. Projections as of November, 1988, by the Minnesota Department of Finance establish that at June 30, 1989, which is the end of the current biennium, and through June 30, 1991, which is the end of the next biennium, the State of Minnesota will have sufficient funds in reserve to pay even the highest amount of refunds that might be due to all taxpayers as a result of this case. (Phase II Stipulation, Exhibit W, pages 24-26.)

30. For all tax years at issue through June 30, 1983, the Minnesota Department of Revenue did not collect, and has stipulated that it will not collect, Minnesota Bank taxes on interest earned from State University Board Bonds issued pursuant to Minn. Stat. § 136.31-38, or from Industrial Revenue Bonds issued prior to July 1, 1979, pursuant to Chapter 474 of the Minnesota Statutes, which was claimed as exempt income. (Phase II Stipulation, ¶ 58.)

CONCLUSIONS OF LAW

31. Unlawful discrimination by the State of Minnesota against Federal obligations cannot be cured by invalidating Minnesota Statutes favoring exempt State University Board Bonds, Industrial Revenue Bonds, or other exempt bonds.

32. This Court concludes that such unlawful discrimination must be cured by striking out language from Minnesota Statutes that caused Federal obligations to be taxed. Accordingly, it is held that Subdivision 13 of Section 290.08 of Minnesota Statutes shall read as follows for the period 1979 through June 30, 1983, with the stricken language severed from the statute:

Subd. 13. Certain exemptions inapplicable to corpora-

tions. Subdivisions 4, 5, 10 and 11 shall not apply to corporations and subdivisions 7 ~~and 8~~ shall not apply to corporations taxable under section 290.02 or under section 290.361.

33. The decision of the United States Supreme Court in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), was decided "under the principles established in [its] previous cases," as the Supreme Court stated in its opinion. 459 U.S. at 398. The Supreme Court did not establish a new principle of law in Memphis Bank.

34. Under principles set forth in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), because the Memphis Bank case did not establish a new principle of law, Memphis Bank applies retroactively to the years at issue in this case.

35. The "new principle of law" test set forth in Chevron is a threshold test. Since Memphis Bank did not establish a new principle of law, it is unnecessary to apply to second and third Chevron tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of Memphis Bank would best be served by retroactive application, and (b) retroactive application of Memphis Bank would not cause an inequitable result.

36. The Court also holds that Memphis Bank should be applied retroactively because the United States Supreme Court did not limit the effect of its decision to prospective-only application. Cf. Welyczko v. U.S. Air, Inc., 733 F.2d 239 (2d Cir.), cert. denied, 469 U.S. 1036 (1984); U.S. v. Fitzgerald, 545 F.2d 578 (7th Cir. 1976).

37. This Court's holdings in Phase I of the case that the Minnesota bank tax was discriminatory and unlawful (Findings of

Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 9 and 10), for which Memphis Bank is cited as authority, are also supported and compelled by the holding of the Minnesota Supreme Court in State v. Duluth M. & N. Ry Co., 207 Minn. 618, 292 N.W. 401 (1939), reh'g denied, 292 N.W. 411 (1940), cert. denied, 311 U.S. 719 (1940).

38. This Court's holdings in Phase I of the case that the Minnesota bank tax was an income tax for purposes of federal statutory and constitutional law, and was therefore unlawful (Findings of Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 11 and 12), was foreshadowed by Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), reh'g denied, 430 U.S. 976 (1977). These holdings did not establish a new principle of law. Accordingly, under Chevron, these holdings apply retroactively to the years at issue in this case.

39. Since this Court's holdings that the Minnesota bank tax is an income tax did not establish a new principle of law, it is unnecessary to apply the second and third Chevron tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of the income tax holdings would best be served by retroactive application, and (b) retroactive application of the income tax rulings would not cause an inequitable result.

40. The Test Banks are entitled to refunds of Minnesota bank taxes for the 1979 test year.

41. In computing refunds due the Test Banks, interest earned on Federal obligations (see paragraph 4, supra) should be excluded from income. Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983); State v. Duluth M. & N. Ry. Co., 207 Minn. 618, 292 N.W. 401 (1939), reh'g denied, 292 N.W. 411 (1940),

cert. denied, 311 U.S. 719 (1940); 31 U.S.C. §742.

42. In computing refunds due the Test Banks, investment operating expenses deducted by the Test Banks (see paragraph 6, supra) should be added back to income. Investment operating expenses were connected with and allocable against Federal obligation interest income, and are thus disallowed as deductions pursuant to Minn. Stat. § 290.10(9).

43. Because cost-of-money operating expenses were not connected with or allocable against interest earned on Federal obligations, the Test Banks' cost-of-money operating expense deductions are not subject to disallowance under Minn. Stat. § 290.10(9).

44. The Court agrees with the parties that interest expense is connected with or allocable against Federal obligation interest (and that an interest deduction should be disallowed) only if the interest expense is paid or accrued on indebtedness incurred or continued to purchase or carry Federal obligations. (Phase II Stipulation, ¶ 26.C.)

45. Because the Test Banks did not incur or continue indebtedness to purchase or carry Federal obligations, the Test Banks' interest expense deductions are not subject to disallowance under Minn. Stat. § 290.09, Subd. 3, or Minn. Stat. § 290.10(9). Cf. Rev. Proc. 70-20, 1970-2 Cum. Bull. 499; Rev. Rul. 61-62, 1961-2 Cum. Bull. 58; I.T. 2028, III-1 Cum. Bull. 296 (1924).

46. The Court agrees with the computations of refunds submitted by the Test Banks as set forth in Exhibits F, H, J and L to the Phase II Stipulation.

47. This matter was presented on a test-case basis. The Norwest Bank Duluth lawsuit encompassed only tax year 1979.

The Cambridge State Bank lawsuit involved numerous banks and tax years 1979 through 1983. Since the parties agreed that the conclusion of the Court would be conclusive as to all tax years at issue and all of Plaintiff Test Banks, there is no just reason for delay of entry of judgment as to the tax refunds due for tax year 1979 to Cambridge, Midway and Sleepy Eye.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that Defendants are adjudged liable to the Plaintiff Test Banks for tax refunds in the following amounts: Norwest, $189, 065; Sleepy Eye, $36,278; Cambridge, $23,833; Midway, $46,574. The Court orders further that interest be paid upon these amounts as required by law.

The Court further finds that there is no just reason for delay in entry of final judgment with respect to the tax refunds for tax year 1979 for Norwest, Cambridge, Midway and Sleepy Eye. Accordingly, the Court expressly directs that judgment be entered immediately in accordance with this Order.

Dated at St. Paul, Minnesota, this _____ day of _____, 1989.

_____

HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT COURT

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et. al.,
Plaintiffs,

vs. File No. C1 84 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,
Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),
Plaintiff,

vs. File No. C4 84 469547

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,
Defendants.

MEMORANDUM

Phase II of the case before the Court was well prepared and tried by all counsel. The efforts on the part of counsel who tried to dispose of the matter by settlement are to be commended. However, because the matter could not be disposed of by settlement, it was necessary for the Court to hold the hearing and to rule

on the issues in Phase II of this case. Primarily, the only issue before the Court was question of damages as far as all of the Plaintiffs are concerned and it should be kept in mind that this is considered a test case in a matter of speaking and, therefore, figures for some of the other Plaintiff banks will have to be determined by counsel.

The key issue as far as the Court is concerned in this matter was whether or not the principles of law announced in the Memphis Bank case should be applied on a prospective basis or a retrospective basis. This matter was vigorously contested and the Court has determined that based on all of the law and the facts at hand, the liability against the State of Minnesota in this matter is to be applied retrospectively. It should be noted that in the Memphis State Bank case, the Supreme Court of the United States did not declare its determination as to retroactivity or prospectivity. As a matter of fact, the federal judicial system has indicated that that question is one of public policy and is to be determined by the respective states. It does appear that if the United States Supreme Court wanted this matter to be handled only prospectively, it would have declared so in its opinion. And also it was declared in the case of Solum versus Stumer, 104 Supreme Court 1338, 1341 (1984) that prospectively is only an exception to the general rule of retroactivity. Counsel have indicated that there is no clear cut precedent here in the State of Minnesota with respect to this question. The Court agrees. The only instance that counsel and Court were able to find were a similar question where a similar question was decided by one of our neighboring states, is the matter of the case of Burlington Northern, Inc., et al versus City of Superior, Wisconsin. This was in the Court of Appeals, District

Three for the State of Wisconsin. And further inquiry has determined that the Supreme Court of the State of Wisconsin has refused to review the matter, so the determination of the Court of Appeals stands.

In this case, the question of retroactivity involves taxes paid by the Plaintiffs to the City was determined in favor of the Plaintiffs.

Now that the Court has concluded that the law is to be applied retroactively, the next question to be determined was whether or not certain deductions were to take place in calculating the refund. The Court did not rule on any of the motions made with respect to the problem and allowed the testimony of two witnesses for the Plaintiffs and two witnesses for the State to assist the Court in determining this matter. After hearing the testimony of all of the witnesses, the Court has determined that the Plaintiff's position in this matter is the correct one and must stand. No further purpose would be served by going into ancillary problems or to reiterate cases that stand as foundation for the Court's Finding of Fact and Conclusions of Law.

S/Harold W. Schultz

Harold W. Schultz
Judge of the District Court

STATE OF MINNESOTA **Supreme Court**

Cambridge State Bank, et. al.,
Respondents,
Norwest Bank Duluth, National Association (formerly First National Bank of Duluth,)
Respondent,
vs.
Arthur C. Roemer, Commissioner, Department of Revenue, and the State of Minnesota,
Appellants.

JUDGMENT

C0-89-2097
Appellate Court Case No.

C1-84-469151 C4-84-469547
Trial Court Case No.

Pursuant to an order of Court heretofore duly made and entered in this cause it is determined and adjudged that the judgment of the Court below, herein appealed from, to wit, of the District Court within and for the County of Ramsey be and the same hereby is affirmed in part, reversed in part in accordance with the opinion and that judgment be entered accordingly. A certified copy of the entry of judgment and the Court's decision is herein transmitted and made part of the remittitur.

Dated and signed: FOR THE COURT April 2, 1992
Dated

Attest: Frederick K. Grittner
Clerk of the Appellate Courts

By: D. Sobcinski
Assistant Clerk

Minn. Stat. § 290.08 (1978) (Denial of exemption from Minnesota bank excise tax for interest on federal obligations).

290.08 EXEMPTIONS FROM GROSS INCOME.

Subdivision 1. In general. The following items shall not be included in gross income, provided that any item which was excluded in arriving at gross income under the provisions of section 290.01, subdivision 20, shall not be again excluded under this section.

* * * *

Subd. 8. Interest from United States. Interest upon obligations of the United States, its possessions, its agencies, or its instrumentalities, so far as immune from state taxation under federal law . . .

* * * *

Subd.13. Certain exemptions inapplicable to corporations. . . . [S]ubdivisions 7 and 8 shall not apply to corporations taxable under section 290.02 or under section 290.361.

Minn. Stat. § 290.361 (1978) (Imposition of Minnesota bank excise tax).

290.361 NATIONAL AND STATE BANKS; IMPOSITION OF EXCISE TAX, COMPUTATION, SURTAX.

Subdivision 1. Imposition of excise tax. An excise tax measured by net income is hereby imposed on national and state banks by this chapter and shall be governed by the provisions of section 290.02.

* * * *

Subd 4. The revenues derived from the excise tax on banks shall be paid into the state treasury and credited to the general fund, from which shall be paid all refunds of taxes erroneously collected from banks as certified by the commissioner.

There is hereby appropriated to the persons or banks entitled to such refunds, from the general fund, an amount sufficient to make the refunds.

Minn. Stat. § 290.50 (1982 and Supp. 1983) (Refund procedures applicable to overpayments of Minnesota bank excise tax).

290.50 OVERPAYMENTS, CLAIMS FOR REFUND OR CREDITS.

Subdivision 1. Procedure, time limit. (a) A taxpayer who has paid or from whom there has been collected an amount of tax for any year in excess of the amount legally due for that year, may file with the commissioner a claim for a refund of such excess. Except as otherwise provided in this section, no claim or refund shall be allowed or made after three and one-half years from the date prescribed for filing the return (plus any extension of time granted for filing the return, but only if filed within the extended time) or after two years from the date of overpayment, whichever period is longer, unless before the expiration of the period a claim is filed by the taxpayer. For this purpose an income tax return or amended return claiming an overpayment shall constitute a claim for refund.

* * * *

Subd. 2. Denial of claim, court proceedings. If the claim is denied in whole or in part, the commissioner shall mail an order of denial to the taxpayer in the manner prescribed in section 290.46. An appeal from this order may be taken to the Minnesota tax court in the manner prescribed in section 271.06, or the taxpayer may commence an action against the commissioner to recover the denied overpayment. Such action may be brought in the district court of the district in which lies the county of his residence or principal place of business or if an estate or trust, of the principal place of its administration, or in the district court for

Ramsey county. The action in the district court shall be commenced within 18 months following the mailing of the order of denial to the taxpayer. If a claim for refund is filed by a taxpayer and no order of denial is issued within six months of the filing, the taxpayer may commence an action in the district court as in the case of a denial, but the action shall be commenced within two years of the date that the claim for refund was filed.

Minn. Stat. § 136.32 (1978) (Exemption from Minnesota bank excise tax for interest on State University Board Bonds).

136.32 BONDS, INVESTMENTS

. . . All bonds issued under sections 136.31 to 136.38 shall be exempt from all taxation. Interest paid on such bonds shall not be included in gross income for the purpose of computing any tax imposed by or under any provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Minn. Stat. § 474.12 (Supp. 1979) (Exemption from Minnesota bank excise tax for interest on Industrial Development Bonds).

474.12 EXCLUSION OF INTEREST ON BONDS FROM GROSS INCOME.

Subdivision 1. Interest paid on bonds issued under authority of this chapter shall not be included in gross income for the purpose of computing any tax imposed by or under the provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Subd. 2. Notwithstanding subdivision 1, the interest paid on bonds issued under authority of this chapter and issued after June 30, 1979 shall be exempt only as provided under section 290.08, subdivision 7, for obligations of the issuing municipality.

MXX01058.WP5

(2)

No. 91-2047

Supreme Court, U.S.
FILED
JUL 15 1992
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In The

Supreme Court of the United States

October Term, 1992

NORWEST BANK DULUTH, N.A.,

Petition,

v.

MINNESOTA COMMISSIONER OF REVENUE AND THE STATE OF MINNESOTA,

Respondents.

CAMBRIDGE STATE BANK, *ET AL.*,

Petitioners,

v.

MINNESOTA COMMISSIONER OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Minnesota Supreme Court

BRIEF IN OPPOSITION

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QUESTION PRESENTED

On remand from this Court, the Minnesota Supreme Court decided that it was required under *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), to apply the rule announced in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), retrospectively to the parties in this case. Petitioners sought refunds of bank excise taxes paid on federal obligation income for periods preceding the *Memphis Bank* decision. The court, however, denied petitioners refunds on the basis that: 1) petitioners were estopped under state law to assert the bank tax was invalid because they accepted the benefits of discriminatory exemptions for state bonds; 2) retroactive taxation of state bond interest was not equitable where petitioners themselves, as investors in state bonds, would have borne the burden of such a tax and where federal obligation immunity principles would not be furthered by retroactive taxation; 3) the appropriate remedy was severance of the offending state bond exemptions; and 4) petitioners failed to use a predeprivation procedure in which they could have challenged the tax prior to payment.

The issue presented is whether, under these circumstances, the decision of the Minnesota Supreme Court raises a substantial federal question despite its compliance with the choice of law retroactivity requirements of *Beam* and applicable due process thresholds established in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1990).

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No. 91-2047

In The

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October Term, 1992

NORWEST BANK DULUTH, N.A.,

Petitioner,

v.

MINNESOTA COMMISSIONER OF REVENUE AND THE STATE OF MINNESOTA,

Respondents.

CAMBRIDGE STATE BANK, *ET AL.*,

Petitioners,

v.

MINNESOTA COMMISSIONER OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Minnesota Supreme Court

BRIEF IN OPPOSITION

The respondents Minnesota Commissioner of Revenue and State of Minnesota respectfully request that this Court deny the Petition of Writ of Certiorari (hereinafter "Pet.") seeking review of the decision of the Supreme Court of Minnesota in this case. The opinion of the Minnesota Supreme Court is reported at 480 N.W.2d 647 and

is reproduced in the appendix to the petition at page 1A (hereinafter "Pet. App."). This decision was issued on remand from this Court for reconsideration in light of *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). The remand order appears at 111 S.Ct. 2881. The initial decision of the Minnesota Supreme Court is reported at 457 N.W.2d 716. Pet. App. 19A.

STATEMENT OF THE CASE

For more than fifty years Minnesota has had a corporate franchise tax which has included interest income on federal obligations in its net income measure. Minn. Stat. § 290.361 (1978) Pet. App. 71A. The interest on two types of state bonds was, however, excluded from gross income for the purpose of computing the franchise tax. An exemption for revenue bonds issued by the Minnesota State University System (SUBs) for construction of dormitories and other college buildings was enacted in 1957. Minn. Stat. § 136.32 (1978). Pet. App. 74A. An exemption for industrial development bonds (IDBs) was enacted in 1967. Minn. Stat. § 474.12 (Supp. 1979). Pet. App. 75A.[1]

[1] The trial court also found that interest earned on obligations of twelve other state and local agencies was also exempt from inclusion in the bank tax, Pet. App. 25A n.10. This is incorrect. The exemption language pertaining to bonds (other than SUBs and IDBs) was insufficient to exempt them from franchise taxes as opposed to income taxes. Numerous bond counsel opinions to that effect were stipulated to in the case. The Minnesota Supreme Court did not reach the issue whether these other bonds were exempt since respondents conceded the

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During the years in which the two exemptions were in effect prior to their repeal in 1983, neither petitioners nor any other taxpayer challenged the bank tax as discriminatory against U.S. obligations.[2]

In 1983 this Court issued its opinion in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which held a Tennessee bank tax which taxed U.S. obligation interest but exempted interest on over 70 types of state and local obligations to be a discriminatory tax in violation of 31 U.S.C. § 742 ((1959) (now codified as 31 U.S.C. § 3124(a) (1982)). The Minnesota Legislature promptly repealed the IDB and SUB exemptions in 1983, thus removing any conceivable discrimination against federal obligations.

Later in 1983 the petitioner banks and virtually all of the more than 700 banks in the state began filing refund claims for bank taxes as far back as 1979, citing the *Memphis Bank* opinion.[3]

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exempt status of SUBs and IDBs, which was sufficient to present the discrimination issue for the court. See Pet. App. 22A n.8 (n.2 in original opinion misnumbered as n.8 at Pet. App. 2A; *see* 457 N.W.2d at 718 n.2). Only the two exemptions for SUBs and IDBs are referred to in petitioners' appendix. Pet. App. 74A-75A.

[2] Taxes were paid by the petitioners without objection for the 1979-1983 tax years for which they later claimed refunds. As to the 1979 tax year – the "test year" stipulated by the parties for purposes of this action – there was no requirement that taxes be prepaid as a condition of challenging them.

[3] To the extent that petitioners may have foreseen the *Memphis Bank* decision, they of course had a strong incentive not to raise the issue prior to the decision, since they benefitted

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In its initial decision issued on July 20, 1990, the Minnesota Supreme Court found that the bank tax was discriminatory. The court denied refunds, however, on three separate grounds. First, the court held that the banks, being large holders of IDBs, had benefitted from the bank tax exemption for such bonds and were therefore estopped from challenging the exemptions under applicable state case law.

Second, the court ruled that the appropriate remedy under Minnesota law was severance of the offending state bond exemptions. The Minnesota court found that it would, if compelled, actually impose a retroactive tax on state bond interest income. The court declined to impose such a requirement, however, because collection would unfairly penalize both the petitioners, as owners of exempt bonds, and the state for failing to foresee that Minnesota's tax exemptions would be unlawful under Memphis Bank. The court also said that imposing retroactive taxation to level the playing field was not required since the state bond exemptions resulted in no adverse comparative economic impact on petitioners vis-a-vis their competitors.[4] Furthermore, the court noted that in this federal obligation immunity case, actually undoing

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from the state bond exemptions that created the problem. It would have been apparent to anyone contemplating such a challenge that the probable outcome of a decision invalidating the bank tax was the repeal of the offending – and to these taxpayers, desirable – state bond exemptions, rather than a repeal of the tax on federal obligations.

[4] Indeed, all banks who purchased state bonds – including petitioners – received the benefit of tax exempt interest income therefrom.

any damage to the federal borrowing power by state policy during the years in question is impossible.

As a third ground for denying refunds, the Minnesota court found that the *Memphis Bank* case should apply prospectively only. In reaching this conclusion, the Minnesota court applied the three-part prospectivety analysis of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). Under the *Chevron* criteria, the court found that: 1) *Memphis Bank* was not clearly foreshadowed; 2) the purposes of federal tax immunity would not be furthered by retroactive application; and 3) retroactive application of *Memphis Bank* would produce substantially inequitable results.

Petitioners filed a petition for writ of certiorari with the United States Supreme Court requesting review of the Minnesota Supreme Court's decision. While the petitioner was pending, the Court decided *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). The Court then granted the petition, vacated the judgment of the Minnesota Supreme Court, and remanded the case to the Minnesota court for further consideration in light of *Beam*.

On remand, the Minnesota Supreme Court reversed its original holding on prospectivity and held that the *Beam* decision requires retroactive application of the substantive rule of federal law established in *Memphis Bank*. However, the court reaffirmed the independent state law grounds for its earlier decision not to award refunds. The court noted that the *Beam* decision preserves the state's right to raise procedural bars to an otherwise required retroactive application of a federal rule of law. *Beam* also affirmed the state's right to fashion an appropriate remedy where the case originated in state court. The court

found the estoppel holding to be a state procedural bar to recovery of refunds as contemplated under *Beam*. The court also held that minimum constitutional due process requirements were met by the fact that, for the tax years in issue, Minnesota law did not require prepayment of tax in order to challenge the validity of the tax. Thus, there were sufficient procedural safeguards, which petitioners failed to use, against unlawful exaction of the tax at the time it was assessed.

As to the court's remaining severance holding, the court based its denial of refunds on the sufficiency of severance as a remedy for the discrimination caused by the tax. The court noted that when the legislature first enacted the bank tax, there were no state obligation tax exemptions; accordingly, the later exemptions (which caused the defect in the tax) could not be said to have invalidated the entire original act.[5]

In addition, the court again noted that the tax had not placed petitioners at an actual comparative economic disadvantage. Accordingly, neither actual imposition of a corrective tax nor a refund of taxes paid was required.

REASONS FOR DENYING THE PETITION

The decision of the Minnesota Supreme Court on remand is consistent with the principles announced by

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[5] The court noted that under these circumstances, severance was mandated by Minnesota's severance statute, Minn. Stat. § 645.20 (1988). Pet. App. 15A, 29A.

the Court in *Beam* and *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1990). Because federal constitutional thresholds have been met, the remedial inquiry is purely a matter of state law. Therefore, no substantial federal question is raised by the petition.

The decision on remand of the Minnesota Supreme Court complied with the *Beam* requirement of retroactive application for choice of law purposes of the substantive rule of federal law established in *Memphis Bank*. Thus this case presents no retroactivity issue, unlike *Harper v. Virginia Dept. of Taxation*, 410 S.E.2d 629 (Va. 1991), *cert. granted*, 60 U.S.L.W. 3779 (1992). Moreover, any due process issues which might otherwise be raised by the denial of refunds are obviated by the availability of a predeprivation right to challenge payment of the tax under Minnesota law for the years at issue. Petitioners' failure to avail themselves of these predeprivation procedures does not entitle them now to challenge the denial of refunds on federal constitutional grounds.

Given the lack of any due process infirmity in light of the availability of a predeprivation remedy, the estoppel and severance grounds for the Minnesota Supreme Court's decision are independent and adequate state law grounds for the decision which should not be reviewed by this court.

I. THE MINNESOTA SUPREME COURT'S DENIAL OF REFUNDS RAISES NO SUBSTANTIAL FEDERAL QUESTION AND WAS CONSISTENT WITH *MCKESSON* WHERE PETITIONERS HAD A FULLY ADEQUATE PREDEPRIVATION REMEDY, WHERE PETITIONERS THEMSELVES WOULD HAVE BORNE THE BRUNT OF A RETROACTIVE EQUALIZING TAX, AND WHERE PETITIONERS SUFFERED NO COMPETITIVE HARM OR COMPARATIVE ECONOMIC DISADVANTAGE AS A RESULT OF THE STATE BOND EXEMPTIONS.

Contrary to petitioner's assertions, this case does not raise significant constitutional issues. Those issues raised by the Minnesota Supreme Court's initial prospectivity ruling under *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) were resolved in favor of petitioners on remand. Any federal issues left unresolved by *McKesson* and *Beam* in connection with intergovernmental immunity cases are more fruitfully addressed in a case such as *Harper v. Virginia Dept. of Taxation*, 401 S.E.2d 868 (Va. 1991), *vacated*, 111 S.Ct. 2883 (1991), *on remand*, 410 S.E.2d 629 (Va. 1991), *cert. granted*, 60 U.S.L.W. 3770 (1992), in which the state court held that it was not obligated retroactively to apply the rule announced in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989).

In *McKesson*, the Court indicated the circumstances in which a state must provide refunds to a taxpayer burdened by a discriminatory tax which violates the Commerce Clause. *McKesson* held that where there is no adequate predeprivation remedy, a state must, in a postdeprivation proceeding, offer a "clear and certain remedy," for any erroneous or unlawful tax collection to

ensure that the opportunity to contest the tax is a meaningful one. Refunds may be constitutionally required in a postpayment proceeding where no other remedy is adequate, as is the case where the taxpayer is absolutely immune from the tax, or where the tax is beyond the power of the state to impose (for reasons other than its discriminatory nature).

A refund may also be required under *McKesson* where the state does not (or cannot) impose a curative tax by assessing and collecting back taxes from a taxpayer's competitors who benefitted from lower taxes in a discriminatory tax scheme. A retroactive curative tax, or refunds in lieu thereof, are particularly likely to be required in a Commerce Clause case like *McKesson*, where the state used its tax laws to further policies of economic protectionism which offend the Commerce Clause, with the result that one class of taxpayers was singled out for favorable tax treatment to their competitors' disadvantage.

Nothing in *McKesson* suggested that its reasoning was limited to application in Commerce Clause cases, however. Citing *Montana National Bank of Billings v. Yellowstone County*, 276 U.S. 499 (1928), the Court in *McKesson* suggested that the same principles should apply in any case involving discriminatory taxation under federal law.

Thus, the Minnesota Supreme Court correctly assumed, in its opinion on remand, that *McKesson* provided the "possible constitutional thresholds" referred to in *Beam* as limiting the state law remedial inquiry. Pet. App. 14A. The Minnesota Supreme Court distinguished

McKesson, however, on the basis that Minnesota unlike Florida did not require prepayment of taxes prior to challenging them, but instead offered a fully adequate predeprivation opportunity to be heard. It is this crucial difference which most clearly distinguishes this case from *McKesson* and *Beam* and is the most compelling reason to deny the petition.

A. *McKesson* is Not Applicable Because Minnesota Provided Predeprivation Relief.

In *McKesson*, the Court explained:

> *[I]f a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a postpayment refund action in which he can challenge the tax's legality,* the Due Process Clause of the Fourteenth Amendment obligates the state to provide meaningful backward-looking relief to rectify any unconstitutional deprivation.

McKesson, 496 U.S. at 31 (emphasis added) (footnote omitted). Relief may be either through additional tax assessments against those benefitting from the discriminatory tax or through refunds to the disfavored taxpayers, or some combination of the two.

But, as the Court stated:

> In contrast, if a state chooses not to secure payments under duress and instead offers a meaningful opportunity for taxpayers to withhold contested tax assessments and to challenge their validity in a predeprivation hearing, payments tendered may be deemed "voluntary." *The availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process*

> *Clause, and taxpayers cannot complain if they fail to avail themselves of this procedure.*

McKesson, 496 U.S. at 38 n. 21 (emphasis added) (citations omitted).

In this case the Minnesota Supreme Court held that during the tax years at issue, Minnesota law allowed an appeal to its tax court *without* prepayment. The court stated, "more important, however, is the fact that, in each year at issue, the banks *could have* avoided paying the tax before challenging its constitutionality. Thus, there were sufficient procedural safeguards against unlawful exactions of the tax *at the time* it was *assessed*." Pet. App. 10A (emphasis in original).

While petitioners characterize this holding as "unprecedented," it is entirely consistent with the Minnesota statutes and cases dealing with tax court jurisdiction.[6] The Minnesota Tax Court has broad authority to decide disputes involving the tax laws of Minnesota.[7] For

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[6] Petitioners claim that in this case the Minnesota Supreme Court held for the first time that relief should be denied because petitioners could have litigated in the Tax Court. Pet. 17. This is incorrect. The court simply held, consistent with *McKesson*, that refunds could *constitutionally* be denied because of the existence of a predeprivation remedy. The substantive grounds for denial of the refunds are the acceptance of benefits estoppel doctrine and severance grounds.

[7] Minn. Stat. § 271.01, Subd. 5 (1980) provides in relevant part: "The tax court shall have statewide jurisdiction. Except for an appeal to the supreme court or any other appeal allowed under this subdivision, the tax court shall be the sole, exclusive, and final authority for the hearing and determination of *all questions of law and fact* arising under the tax laws of the state, as defined in this subdivision, in those cases that have been appealed to the tax court and in any case that has been transferred by the district court to the tax court." (Emphasis added.)

the 1979-80 tax years, Minnesota law did not require prepayment in order to challenge the validity of a tax. Minn. Stat. § 271.09, subd. 3 (1978) provided that "at the time of taking an appeal to the tax court, the taxpayer shall pay at least the amount of the tax or other obligation *conceded by the taxpayer to be due, if any,* when it becomes due. . . . " (Emphasis added.) Petitioners concede this to be the case. Pet. 15-16. They claim, however that Minnesota "case law" in 1980 indicated that the only procedure available to challenge the constitutionality of a tax was the refund procedure followed by petitioners in this case.[8] Pet. 18. Here too, petitioners are mistaken.

As the Minnesota Supreme Court expressly reaffirmed in its opinion in this case, prior to 1980, the tax court had subject matter jurisdiction over constitutional challenges to taxes assessed. Pet. App. 9A.[9] In September,

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[8] Petitioners also imply that they are entitled to refunds simply because they fully complied with the procedural requirements of the refund statute, Minn. Stat. § 290.50 (1982 & Supp. 1983). However, nothing in that statute requires the court to award refunds in particular cases, precludes the commissioner from raising procedural bars or equitable defenses to the claim, or establishes substantive principles of law for the determination of cases. The statute merely authorizes refund claims and establishes procedures for their resolution, and is silent as to the circumstances in which such claims may be granted or denied. It does not follow that Minnesota is constitutionally required to award refunds simply because it has a statutory framework for making claims. The cases cited by the petitioners in which taxpayers were awarded refunds are therefore irrelevant. *See also infra* note 15.

[9] The Minnesota Supreme Court's determination as to the procedures available under state law for the test year of 1979 is

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1980, in *In re McCannel*, 301 N.W.3d 910, 920 (Minn. 1980), the Minnesota Supreme Court held that the tax court, as part of the executive branch, had only such authority to hear and decide constitutional issues as was conferred on it by the state's district courts. In subsequent decisions, however, the court made it clear that it would continue to consider constitutional issues raised in tax court cases filed prior to the date of the *McCannel* decision. *Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138, 139 n.1 (Minn. 1980); *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261, 264 (Minn. 1984).

Moreover, even after *McCannel*, parties continued to be able to raise constitutional questions in prepayment tax court proceedings by the simple expedient of filing the tax court appeal and moving the tax court for transfer of constitutional issues to state district court. The district court could then either retain those issues for decision or transfer them back to tax court complete with constitutional jurisdiction. *See, e.g. Nagaraja v. Commissioner of Revenue*, 352 N.W.2d 373 (Minn. 1984). (transfer procedure used in 1982 to confer constitutional jurisdiction on tax court in appeal filed in 1981). This procedure was

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presumably final, and should not be disturbed by this Court. *See American Trucking Ass'ns, Inc. v. Smith*, 496 U.S. 167, 177 (1990) (comity requires the Court carefully to disentangle issues of federal law from those of state law and to refrain from deciding anything apart from questions of federal law directly presented).

described and formally sanctioned by the Supreme Court in *Erie Mining*.[10]

Thus, for the test year selected by the parties, 1979, Minnesota law clearly allowed an appeal to its tax court *without* prepayment.[11] Minnesota therefore did provide for meaningful predeprivation relief and the threshold requirement for retroactive relief of any sort cannot be established by petitioners under *McKesson*. The petition should be denied on this basis alone.

B. *McKesson* Does Not Require A State To Provide Relief in the Form of Refunds In Intergovernmental Immunity Cases Where Refunds Would Not Further The Principles Of Federal Obligation Tax Immunity.

Petitioners argue that this Court should nevertheless grant certiorari to hold that *McKesson* requires refunds in Supremacy Clause cases (apparently regardless whether predeprivation relief is available) for three reasons. First,

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[10] As demonstrated by the *Nagaraja* case, other parties had no trouble figuring out how to litigate constitutional issues in tax court well before *Erie Mining*, despite petitioners' assertion that prescience was required. Pet. 19 n.11.

[11] No prepayment requirement was enacted until the 1981 tax year. Even when there was a prepayment requirement (since repealed), a taxpayer could avoid prepayment by showing that the appeal was in good faith, that there was probable cause that the taxpayer would be found exempt from the tax or that the tax ultimately determined might be less than fifty percent of that assessed and that prepayment would work a substantial hardship. Minn. Stat. § 290.531 (1982).

petitioners argue that the Minnesota bank excise tax was "beyond the state's power to impose" and that under *McKesson*, "[s]ince there is no way to 'cure the invalidity of the tax,' the tax must be refunded." Pet. 12. Second, petitioners claim that "[t]he Minnesota Supreme Court's decision, if not reversed, would effectively end private enforcement of immunity doctrine rights." Pet. 13. Finally, petitioners claim that the Minnesota Supreme Court's decision conflicts with a recent decision of the Ninth Circuit Court of Appeals, *United States v. City of Spokane*, 918 F.2d 84 (1990), *cert. denied*, 111 S.Ct. 2888 (1991) Each of these asserted reasons for granting the petitioner is spurious.

First, the Minnesota bank excise tax is not "beyond the state's power to impose" nor are petitioners "absolutely immune from the tax." Applicable federal law expressly authorizes nondiscriminatory corporate franchise taxes which include interest on federal obligations in the computation of the tax. 31 U.S.C. § 742 (1959) (now codified at 31 U.S.C. § 3124 (a) (1982)). The Minnesota bank excise tax was concededly valid, but for the offending exemptions for IDBs and SUBs.

Nothing in *McKesson* suggests that different principles apply to discriminatory taxes challenged under the Supremacy Clause rather than the Commerce Clause. In fact, the contrary conclusion is suggested by *Montana National Bank of Billings v. Yellowstone County*, 276 U.S. 499 (1928), discussed in *McKesson*, 496 U.S. at 34-35, where this Court stated, "we applied the same due process analysis to a tax that was unlawful because it was *discriminatory*, though otherwise within the state's power to

impose." (Emphasis in original). Instead, the Court suggested in the following language that certain cases might require refunds for other reasons:

> Had the Florida courts declared the liquor tax invalid either because (other than its discriminatory nature) it was beyond the state's power to impose, as was the unapportioned tax in *O'Connor*, or because the taxpayers were absolutely immune from the tax, as were the Indian tribes in *Ward* and *Carpenter*, no corrective action by the state could cure the invalidity of the tax during the contested period. The state would have had no choice but to "undo" the unlawful deprivation by refunding the tax previously paid under duress, because allowing the state to "collect these unlawful taxes by coercive means and not incur any obligation to pay them back . . . would be in contravention of the Fourteenth Amendment." (Citations omitted).

McKesson, 496 U.S. at 39.

What distinguishes this case from *McKesson* and *Montana National Bank* is not, as petitioners argue, the clause of the Constitution under which the tax is attacked, but the factors cited in the Minnesota Supreme Court's opinion. First, Minnesota offered meaningful prepayment relief, unlike Florida in *McKesson* or Montana in *Montana National Bank*. Second, rather than being victims of a discriminatory tax, petitioners personally benefitted from the very tax exemptions which created the discriminatory effect. Finally, a retroactive "curative" tax would have primarily fallen on the very taxpayers challenging the validity of the discriminatory tax scheme.[12] It is these

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[12] Ironically, as heavy investors in IDBs, petitioners are economically better off under the remedy actually chosen in

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factors which supported the Minnesota Supreme Court's decision as to the appropriate remedy in this case, and not any purported distinction between Commerce Clause and Supremacy Clause jurisprudence.

Petitioners also raise the spectre of an end to private enforcement of intergovernmental immunity doctrine rights. This is nonsense. As acknowledged in *McKesson*, there can be no chilling effect from a denial of refunds in a postdeprivation proceeding where a state also offers a prepayment remedy. Second, the federal government is not helpless to defend its own interests under the Supremacy Clause generally and under 31 U.S.C. § 742 specifically.[13] It has often commenced suits to declare state taxes unconstitutional.[14]

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this case, severance of the offending state exemptions, than they would have been had the court imposed a curative tax on the exempt bonds, a remedy which clearly passes constitutional muster under *McKesson*.

[13] While petitioners acknowledge that it is possible that the federal government could sue to prevent discrimination, they claim they have not been able to find a single case under section 742 in which the federal government has done so. Pet. 13. That fact alone indicates that there is no shortage of private plaintiffs prepared to attack discriminatory taxes. Moreover, on the very next page of the petition, the banks cite an intergovernmental immunity case involving the United States as plaintiff. *United States v. City of Spokane*, 918 F.2d 84 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991). Pet. 14.

[14] *See, e.g., United States v. County of Fresno*, 429 U.S. 452 (1977) (government challenged tax on government-owned housing used by private citizens); *United States v. New Mexico*, 455 U.S. 720 (1982) (government challenged a sales/use tax on goods and services purchased by private contractors under contracts with U.S. to manage government-owned laboratories).

This case also presents a relatively rare combination of facts which are not likely to be duplicated. Few cases will involve taxpayers who do not object to a discriminatory tax scheme for 25 or more years, who benefit from the very discrimination complained of, and who fail to utilize prepayment challenge procedures. The denial of a refund remedy in this case hardly means that state governments "will be able to impose discriminatory taxes with impunity." Pet. 13.

This case is squarely within the parameters of *McKesson* due process requirements, and in no way expands the area in which states may constitutionally deny tax refunds. The narrow impact of this case is demonstrated by another recent decision under 31 U.S.C. § 3124(a) cited by petitioners, in which the Minnesota Supreme Court affirmed the award of refunds to taxpayers (who, unlike the banks, had not benefitted from discriminatory tax exemptions). *Yurista v. Commissioner of Revenue*, 460 N.W.2d 24 (Minn. 1990).[15]

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[15] Although *Yurista* involved refunds, other Minnesota tax cases have resulted in other types of remedies. For example, in *Johnson Brothers Wholesale Liquor Co. v. Commissioner of Revenue*, 402 N.W.2d 791 (Minn. 1987), the court severed a statutory provision imposing lower liquor tax rates on locally produced wine and retroactively imposed a compensating tax on the favored wine producers, thus correcting discriminatory taxes which were found to violate the Commerce Clause under *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984). In light of the severance remedy, the court held that the plaintiff in *Johnson Brothers* was not entitled to refunds.

Petitioners also endeavor to manufacture a conflict between the decision in this case and the *City of Spokane* decision. In that case the Ninth Circuit Court of Appeals struck down a tax imposed by the city on the American Red Cross, which the court held to be an instrumentality of the United States. Given that the state had no power to exact a tax from a federal instrumentality (whether or not the tax was discriminatory), the court ordered the improperly taken tax monies refunded as "the only logical relief." 918 F.2d at 89. The *City of Spokane* court did not hold, as petitioners assert, that a tax that violates the intergovernmental immunity doctrine must in all cases be refunded. Rather, it held, consistent with *McKesson*, that a tax collected from an entity *absolutely immune* from state taxation must be refunded.

There is a world of difference between the type of tax in *City of Spokane* and the bank excise tax here, which, but for the two state bond exemptions, was clearly within the state's power to impose. Petitioners are neither absolutely immune from taxation, nor is the bank excise tax (other than for its discriminatory nature) beyond the state's power to impose. The supposed conflict between *City of Spokane* and this case is thus wholly illusory. Because this decision presents no conflict either with *McKesson* or the intergovernmental immunity cases, the petition should be denied.

II. THE STATE LAW ESTOPPEL GROUND FOR THE MINNESOTA SUPREME COURT'S DECISION IN THIS CASE DOES NOT RAISE A SUBSTANTIAL FEDERAL QUESTION.

On remand, the Minnesota Supreme Court also reaffirmed its original holding that, under a well established line of Minnesota cases, the banks were estopped from asserting the unconstitutionality of the Minnesota bank tax.

Petitioners urge the Court to review the estoppel holding because it allegedly does not have a "fair or substantial basis." Pet. 22-24. They also assert that the estoppel holding means that "as a precondition to challenging a discriminatory tax on federal obligations, petitioners would have had to pay an alternative form of discriminatory tax on state obligations." Pet. 22. Petitioners' argument is based on a gross mischaracterization of the state court's ruling. Moreover, it fails to raise a substantial federal question in light of the Minnesota court's holdings in this case as to retroactivity and predeprivation remedies.

Petitioners apparently argue that the Minnesota Supreme Court estopped petitioners' recovery of refunds because they failed to pay a judicially imposed tax.[16]

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[16] In making this argument petitioners again ignore the fact that payment of a tax was not a prerequisite for challenging its validity for the time period at issue. Petitioners do not argue, and the Minnesota Supreme Court did not hold, that petitioners would have been estopped to raise the constitutional issue in a prepayment challenge to an assessment by the commissioner.

Nothing in either opinion of the Minnesota Supreme Court suggests this rationale. Instead, the court expressly held that it was petitioners' enjoyment of the tax benefit of the challenged exemption that gives rise to estoppel. Pet. App. 11A-12A, 27A.

A. Estoppel Is A Well-Recognized Principle Under Both State And Federal Law.

That certain taxpayers may be estopped from raising claims challenging the validity of tax schemes is a well recognized principle under both state and federal law. Minnesota has long recognized an acceptance of benefits doctrine in tax cases, under which a taxpayer is estopped from assuming the validity of a statute for the purpose of receiving its benefits while also attacking it as unconstitutional in an attempt to receive even greater rewards. *See Gale v. Commissioner of Taxation*, 37 N.W.2d 711 (1949) (taxpayer who claims tax reduction as result of statutory amendment estopped from challenging effective date of amendment). The estoppel doctrine of "acceptance of benefits" has also been applied in federal cases,[17] as in,

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[17] When applied in federal tax cases the acceptance of benefits doctrine is variously known as the "duty of consistency" or "quasi-estoppel." Under this doctrine, a taxpayer who has received a tax benefit due to treatment of an item in a year barred by the statute of limitations as to an additional assessment is precluded from claiming that the original treatment was incorrect in order to obtain a tax advantage in a later year. *See Beltzer v. United States*, 495 F.2d 211, 212 (8th Cir. 1974); *Unvert v. Commissioner*, 72 T.C. 807 (1979), *aff'd on other grounds* 656 F.2d 483 (9th Cir. 1981); *Griffith v. Commissioner*, T.C.M. (P-H) ¶89,070 (1989); *Coldiron v. Commissioner*, T.C.M. (P-H) ¶87,569 (1987).

for example, *Arnett v. Kennedy*, 416 U.S. 134, 152-53 (1974) (plurality opinion) (Court viewed skeptically action of litigant in challenging constitutionality of portions of federal civil service statutes under which he simultaneously claimed benefits); *Magee v. United States*, 282 U.S. 432 (1931) (taxpayer who benefitted from claim in abatement not in position to challenge its legality); and *Strickland v. Flue-Cured Tobacco Coop. Stabilization Corp.*, 643 F. Supp. 310 (D.S.C. 1986) (rebate beneficiaries of federal tobacco price support program barred under doctrine of constitutional estoppel from attacking the statute authorizing rebates). The Court has also applied estoppel as a matter of federal common law, in order to preserve significant policy interests and prevent unjust results. *D'Oench, Duhme & Co., Inc. v. Federal Deposit Insurance Corporation*, 315 U.S. 447 (1942) (maker of note estopped to assert lack of consideration as defense to suit on note brought by FDIC as insurer of lending bank).

Likewise, under the federal doctrine of constitutional estoppel, this Court has refused to allow litigants to challenge statutes under which they have voluntarily accepted benefits. In *Fahey v. Mallonee*, 332 U.S. 245 (1947), the Court held that "[i]t is an elementary rule of constitutional law that one may not retain the benefits of the act while attacking the constitutionality of its important conditions," and that "[t]he court will not pass upon the constitutionality of a statute at the instance of one who has availed himself of its benefits." *Id.* at 255 (citations omitted). *See also Federal Deposit Insurance Corporation v. American Bank Trust Shares, Inc.*, 460 F. Supp. 549, 556-57 (D.S.C. 1978) (finding that *Fahey* has not been modified or overruled and holding plaintiffs estopped

from contesting constitutionality of statutes), *aff'd on other grounds*, 629 F.2d 951 (4th Cir. 1980).

Moreover, equitable considerations have long been recognized as appropriate to the determination of a remedy in tax refund actions. In *Stone v. White*, 301 U.S. 532 (1937), the Court held that an "action, brought to recover a tax erroneously paid, although an action at law, is equitable in its function." 301 U.S. at 534. The Court stated:

> Since, in this type of action, the plaintiff must recover by virtue of a right measured by equitable standards, it follows that it is open to the defendant to show any state of facts which, according to those standards, would deny the right. . . .

Id. 535 (citations omitted). Thus, use of estoppel doctrines to deny refunds in tax cases is not a revolutionary idea at either the state or federal level.

Petitioners claim, however, that estoppel should not apply to them since 1) they did not challenge the state obligations exemptions, the benefit of which they received, and 2) the benefit of the exemptions was "wholly illusory" because the interest rates on exempt state obligations "were lower than they would otherwise have been if the obligations had been taxable." Pet. 23. Neither argument is well taken.[18]

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[18] Petitioners also make the puzzling assertion that if the estoppel doctrine were a valid basis for denying tax refunds, then the taxpayers in *Memphis Bank* and *Schuylkill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935) should have been estopped. It

(Continued on following page)

First, had it not been for the state bond exemptions, there would have been absolutely no basis for petitioners' complaints. To challenge the Minnesota bank excise tax as discriminatory, they were forced to assert the exemptions were unlawful. As a franchise tax, Minnesota's bank excise tax may lawfully include U.S. obligation income in its measure, consistent with 31 U.S.C. § 3124(a) (1982). Inclusion of U.S. obligation income in the Minnesota tax did not make the tax unlawful. As the Minnesota court held: "It is the exemption for interest earned on state obligations that makes the bank tax discriminatory and, therefore, unconstitutional." Pet. App. 28A. Petitioners' claim that they did not really challenge the exemptions for state obligations which created the discriminatory effect is therefore disingenuous and was rightly rejected by the Minnesota court.[19]

(Continued from previous page)

is not clear why petitioners believe that litigants in Tennessee and Pennsylvania should have achieved the same results under the laws of their states, which may differ on such matters as estoppel, laches and statutes of limitations. In any event, there is no indication that the parties in those cases raised an estoppel issue, even if the doctrine was recognized in their states.

[19] *Kadrmas v. Dickinson Public Schools*, 487 U.S. 450 (1988), cited by petitioners, is inapposite since it does not involve a tax benefit which was part and parcel of the tax whose constitutionality was being attacked. In *Kadrmas*, the court noted that plaintiffs were actually *burdened* (they were required to pay a school bus transportation fee) rather than *benefitted* by the statute they challenged, and were therefore not estopped by their supposed "enjoyment" of the bus transportation. Likewise, *Nash v. Florida Industrial Commission*, 389 U.S. 235 (1967), is inapposite, since the issue there was not estoppel, but whether a state can refuse to pay unemployment insurance to persons solely because they have brought federal unfair labor practice charges against their employer.

Second, petitioners assert that they did not really benefit from the state bond exemptions because interest rates on exempt state obligations were lower than they otherwise would have been if the obligations had been taxable.[20] Petitioners' argument requires the Court to accept implicit assumptions not supported by the trial record. The Court is asked to assume that there was a dollar reduction in interest earned for each dollar of tax exemption received; that tax exemptions for bonds are of no net benefit to bond holders; that the entire benefit of tax exemption for tax-exempt bond issues goes to the bond issuers rather than to bond holders; and that apparently the banks invested in state bonds contrary to their own economic interest. If these assumptions are true, one wonders why investors did not flee from IDBs and SUBs in droves, thereby improving rather than damaging the federal borrowing power.

In any event, it is clear that petitioners took advantage of the very exemptions for state obligations which created the discriminatory impact on federal obligations. Whether they made or lost money on their investment in state obligations is beside the point. They clearly accepted a *tax benefit* from the state bond exemptions.[21] It

---

[20] Contrary to petitioners claim that the Minnesota court "conceded that the economic benefit to petitioners was 'wholly illusory'," Pet. 23, the court merely noted that the trial court's findings supported the claim that interest paid on exempt state obligations was lower than it would have been without the exemption. Pet. App. 11A.

[21] As the Minnesota Supreme Court observed, "Respondents do not dispute that they accepted the tax benefits of the exemption for interest on State of Minnesota obligations." Pet. App. 27A.

is the petitioners' acceptance of the tax benefit, and not the profitability of their investment, that gives rise to estoppel.

Thus, the Minnesota decision does not establish a new principle fatal to refund actions challenging unconstitutional taxes. The decision merely applies well-established equitable doctrines to the facts in this case. While other taxpayers who did not own exempt state obligations may challenge the tax as discriminatory these petitioners may not. The decision affects only litigants like petitioners who want to have their cake and eat it too.

B. *Beam* Does Not Preclude Consideration Of Individual Equities in Particular Cases.

The application of equitable interests in state tax cases was expressly reserved to the courts in *Beam*, which acknowledged that the question of an appropriate remedy is governed by state law, subject only to possible constitutional thresholds:

> [N]othing we say here precludes consideration of individual equities when deciding remedial issues in particular cases.
>
> . . .
>
> *Nor do we speculate about the remedy that may be appropriate in this case;* remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by reference to our decision last Term in *McKesson*. As we have observed repeatedly, federal "issues of remedy . . . may well be intertwined with, or their consideration obviated by issues of state law." *Nothing we say here*

> *deprives respondent of his opportunity to* raise procedural bars to recovery under state law or *demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which McKesson did not deal.*

Beam, 111 S. Ct. at 2448 (emphasis added) (citations omitted).

Neither the acceptance of benefits doctrine nor any similar estoppel doctrine was at issue in *Beam*. Retroactivity as a remedial principle (rather than as a choice of law principle) clearly recognizes the equitable and reliance interests of the parties. Nothing in either *McKesson* or *Beam* should be seen therefore as inconsistent with application of such traditional equitable doctrines in tax cases.

The justice in applying an estoppel to these petitioners' claims of discrimination is plain. Petitioners are the type of taxpayer who should be properly estopped from asserting that a tax is discriminatory. All four of the test banks (petitioners) were holders of IDBs. All four reduced their Minnesota bank taxes by claiming the IDB interest as exempt income. They so stipulated.

Respondents were properly estopped from challenging the exemptions which caused the discriminatory effect of which they complained. They had benefitted from those very exemptions for over twenty-five years. They used the exemptions to reduce their tax liabilities for the years for which they now seek refunds. As the Minnesota Court noted, granting the banks millions of dollars in refunds[22] now would provide them an

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[22] At trial respondents presented evidence that approximately $122 million in tax and another $66 million in interest (through March 31, 1990) was claimed by petitioners and all

(Continued on following page)

undeserved windfall by allowing them to have operated essentially tax-free during the periods in question while they silently reaped the benefits of the discriminatory state bond exemptions. Pet. App. 33A.

Application of state law estoppel principles to bar claims in appropriate cases is unaffected by *Beam*, which recognized that states have options and flexibility in fashioning remedies. The Minnesota court responsibly exercised its judgment to fashion an appropriate remedy in this case. *Beam* recognized that in cases originating in state court, state law procedural and remedial issues do not ordinarily raise substantial federal issues. Particularly here, where petitioners could have challenged the tax in a prepayment proceeding, no federal issue justifying further review has been raised.

(Continued from previous page)

other Minnesota banks which have filed refund claims. The trial court found this amount to be "speculative," Pet. App. 60A-61A. The Minnesota Supreme Court did not address this issue, merely observing that "Respondents have not explained how the borrowing power of the United States will be protected by allowing them to receive multimillion dollar refunds." Pet. App. 32A.

CONCLUSION

For the foregoing reasons the petition should be denied.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1992

NORWEST BANK DULUTH, N.A.,
Petitioner,

v.

MINNESOTA COMMISSIONER OF REVENUE
and the STATE OF MINNESOTA,
Respondents.

On Petition for Writ of Certiorari to the Minnesota Supreme Court

---

BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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IN THE

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No. 91-2047

NORWEST BANK DULUTH, N.A.,
Petitioner,

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Respondents.

On Petition for Writ of Certiorari to the Minnesota Supreme Court

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondents have been obtained and filed with the Clerk of Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a nonprofit association, which was originally organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incorporated January 1, 1992, has a membership of 372 major

multistate corporations. COST member companies conduct a substantial portion of the interstate commerce of United States taxpayers and are representative of that part of the nation's business sector which is directly affected by state taxation of interstate operations.

COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of corporations doing business in more than one taxing jurisdiction. This objective is accomplished, in part, through the promotion of procedural rights of taxpayers. One such procedural right is the right to a remedy when a state tax is found to be illegal or unconstitutional. Therefore, COST has a great interest in the instant case, in which the State of Minnesota has denied taxpayers any remedy, even though the tax at issue has been held to be illegal and unconstitutional pursuant to this Court's decision in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983).

SUMMARY OF ARGUMENT

This case involves the inclusion in a State's tax base of federal obligation interest while certain state obligation interest was excluded in violation of a federal statute and the intergovernmental tax immunity doctrine under the Supremacy Clause. In accordance with this Court's decision in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which invalidated a virtually identical tax scheme, the Minnesota Supreme Court properly held that the State's taxation of federal obligation interest was unconstitutional. The Minnesota Supreme Court also correctly held, on remand from this Court, that consistent with this Court's decision in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), the holding in *Memphis Bank* must be applied retroactively. Nevertheless, under the guise of "state procedural bars", the Minnesota Court refused to grant any remedy to the taxpayer in this case.

The refusal of the Minnesota Supreme Court to grant a remedy where an illegal and unconstitutional tax has been collected by the State is a not too subtle attempt to protect the State treasury at the expense of due process rights of taxpayers. The court's refusal to require refunds of taxes collected in violation of 31 U.S.C. § 742 fails to give effect to that statute and fails to remedy the Supremacy Clause violation.

This Court's decision in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990) makes clear that due process requires that a state provide a clear and certain remedy where it has exacted an illegal or unconstitutional tax. In this case, the tax unconstitutionally discriminated against the federal government, and, therefore, is void and may not be exacted. *Moses Lake Homes v. Grant County*, 365 U.S. 744, 752 (1961). And, when a State attempts to impose a tax which is beyond the State's power to impose, as is the case here, "[t]he State would have no choice but to 'undo' the unlawful deprivation by refunding the tax previously paid", *McKesson, supra* at 2251, in order to comport with due process.

The Minnesota Supreme Court, in both its original decision, *Cambridge State Bank v. Roemer*, 457 N.W.2d 716 (Minn. 1990), and on remand, *Cambridge State Bank v. James*, 480 N.W.2d 647 (Minn. 1992), has given no more than lip service to the Due Process Clause, the Supremacy Clause, federal law and the precedents of this Court. While this case involves the right to a remedy and *Harper v. Virginia Dept. of Taxation*, 242 Va. 322, 410 S.E.2d 629 (1991) *cert. granted*, 60 U.S.L.W. 3779 (1992), involves the retroactive application of a decision of this Court, in both cases, the state courts have flouted taxpayers' constitutional right in a blatant attempt to protect the state treasury. The United States Court of Appeals for the Ninth Circuit recognized that where a tax has been exacted from a federal instrumentality, as is the

cases here, "[t]he only logical relief, aside from precluding further taxation, is to order the improperly taken monies refunded." *United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991). The Minnesota Supreme Court is unwilling and unable to recognize this rule without an express order from this Court. Therefore, this Court should grant certiorari and reverse the decision of the Minnesota Supreme Court.

ARGUMENT

WHEN A TAXPAYER HAS PAID A TAX THAT DISCRIMINATES AGAINST THE FEDERAL GOVERNMENT IN VIOLATION OF FEDERAL LAW AND THE SUPREMACY CLAUSE, THE ONLY MEANINGFUL REMEDY AND THE REMEDY REQUIRED BY THE DUE PROCESS CLAUSE IS THE PAYMENT OF REFUNDS

In *McKesson Corporation v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 22 (1990), this Court stated that its precedents

> establish that if a State penalizes taxpayers for failure to remit their taxes in timely fashion, thus requiring them to pay first and obtain review of the tax's validity later in a refund action, the Due Process Clause requires the State to afford taxpayers a meaningful opportunity to secure postpayment relief for taxes already paid pursuant to a tax scheme ultimately found unconstitutional.

This holding requires that the State of Minnesota refund the unconstitutionally collected tax in this case. The only "meaningful backward-looking relief", *McKesson*, *supra* at 31, for due process purposes where a federal statute and the intergovernmental tax immunity doctrine under the Supremacy Clause have been violated is the refund of the illegal tax. *See*, Petitioners' Petition for Writ of Certiorari at 11-12.

Nevertheless, in determining the appropriate remedy, the Minnesota Supreme Court held that the refund of the

illegal taxes was not required. The Minnesota court found that *McKesson* should be distinguished "on the ground that tax schemes invalidated under the commerce clause involve considerations of comparative economic disadvantage which are not present here." *Cambridge State Bank v. James*, 480 N.W.2d 647, 653 (Minn. 1992) ("Cambridge II"). In so holding, the court failed to take the next obvious step and look to the considerations that are at play where the tax scheme is invalidated under a federal statute, the Supremacy Clause and the doctrine of intergovernmental immunity. If the court had done so, it may have still distinguished *McKesson*, but only to hold that in this case the refunding of taxes is the only remedy available to protect those considerations.

The federal law at issue, 31 U.S.C. § 742, provided:

> Except as otherwise provided by law, *all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority.* This exemption extends to every form of taxation that would require that the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.[1]

Unlike the Commerce Clause, which is intended to prevent discriminatory treatment that will cause economic disparities for interstate taxpayers, the statute at issue is intended to protect the federal government. It is a statutory restatement of "the constitutional rule of tax immunity established in *McCulloch v. Maryland*, 4 Wheat. 316 (1819), [that] 'States may not impose taxes directly on the Federal Government, nor may they impose taxes the legal incidence of which falls on the Federal Government.' *United States v. County of Fresno*, 429 U.S. 452,

[1] This statute is now codified, with minor amendments not affecting the language at issue herein, at 31 U.S.C. § 3124(a).

459 (1977)." *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 397 (1983). The Constitutional infirmity in the challenged tax is not that it discriminates against the taxpayer in favor of any other person, but that it discriminates against federal obligations in favor of securities issued by the State. See, *Memphis Bank*, *supra*, at 398. Thus, it is the illegal taxation of the federal government that is the harm to be remedied. The only means of remedying this constitutional and statutory violation is to require the refund of the illegally collected tax.[2]

The Minnesota Supreme Court has somehow convinced itself that by severing the exemptions for state obligations, but refusing to either impose a retroactive tax or grant refunds of the illegal tax paid on federal obligations, it has provided "meaningful backward looking relief," as required in *McKesson*, *supra* at 31. In fact, the court, quite obviously, provided no relief at all. The court's actions, taken together, leaves in place the illegal and unconstitutional tax scheme, providing no remedy to the taxpayer and no protection to the federal government from state taxation.

The Minnesota court's most disingenuous rationale for denying the taxpayer a refund of the illegally collected tax is that the taxpayer is estopped from claiming a refund because it also held some of the exempt state bonds and it did not remit taxes on the interest received from these bonds. Thus, according to the Minnesota Su-

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[2] *McKesson Corporation v. Division of Alcoholic Beverages and Tobacco* 496 U.S. 18, 40 (1990) held that, consistent with due process, the State of Florida could cure the commerce clause violation by either granting a refund or by collecting back taxes from the taxpayer's competitors. However, retroactive assessment beyond "some temporal point" may "violate due process by unduly interfering with settled expectations." *McKesson*, *supra* at 40, fn. 23. In this case, the Minnesota Supreme Court specifically held that the retroactive assessment of tax against purchasers of exempt state obligations would be unconstitutional. *Cambridge State Bank v. James*, 480 N.W.2d 647, 654 (1992). Thus, such a remedy is not at issue in this case.

preme Court, the taxpayer is left without a remedy because it filed its return in compliance with State law and took advantage of exemptions available to it and then had the temerity to challenge one provision of the State's tax scheme. This argument must be rejected for two reasons. First, the acceptance of the benefits doctrine is not the type of procedural bar to refunds envisioned by this Court in *McKesson*, *supra* and *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). Second, as shown in Petitioner's Brief, the court below did not properly apply the doctrine in this case. Petition for Writ of Certiorari, at 22-24.

In *McKesson*, this Court recognized that the State of Florida "could invoke, as an independent basis for denying the refund, taxpayer's failure to comply with the notice requirement that was in effect at the time of the tax payments", such as a requirement that the payment be made under protest or that notice of a refund claim be given with a certain time period. 496 U.S. at 25, fn.4; 45. Similarly, in *Beam*, this Court recognized that the State could raise "procedural bars to recovery under state law", 111 S. Ct. at 2443, stating that a statute of limitations would be such a procedural barrier. *Id.* Thus, while states can raise procedural bars to the payment of refunds, it is clear from these cases that this Court envisioned such procedural bars to be just that—instances where a taxpayer failed to follow the statutorily mandated procedures for claiming a refund of taxes paid to the State. There has been no suggestion in this case that the taxpayer did not fully comply with state refund procedures and there are no independent state grounds to justify the denial of refunds.

The Minnesota Supreme Court has blatantly ignored this Court's decision in *McKesson* in an attempt to protect the State's treasury. It looked to the State's "equitable interests", that is, "its potential liability", *Cambridge II*, *supra* at 654, as justification for its decision even though such equitable considerations were explicitly re-

jected by this Court as grounds for providing only prospective relief. *McKesson*, *supra* at 44, 45.

The Minnesota Supreme Court has ignored due process and the precedents of this Court in order to allow the State to retain taxes that were collected in violation of a federal law and the Supremacy Clause. While COST recognizes the importance of fiscal integrity to a State, the State may still protect itself by providing refunds on an installment basis or as credits against future taxes.[3] See, *McKesson*, *supra* at 45. Due Process requires that a meaningful remedy be granted in this case. Under the circumstances in this case, the only available remedy that addresses the concerns of the statute, provides meaningful relief and comports with due process is the granting of refunds.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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Dated: July 21, 1992

[3] The State must, of course, still pay interest as provided by statute should it choose to pay refunds by either of these two options.

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Respondents.

Cambridge State Bank, et al.,
Petitioners,
v.
Minnesota Commissioner of Revenue,
Respondent.

On Petition for Writ of Certiorari To The Minnesota Supreme Court

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On Petition for Writ of Certiorari To
The Minnesota Supreme Court

PETITIONERS' REPLY BRIEF

The Petitioners respectfully submit this Reply Brief in response to the Brief in Opposition filed by Respondents.[1]

I. The Minnesota Supreme Court's Denial of Retroactive Relief Raises a Substantial Federal Question.

Respondents observe that the instant case is "unlike" *Harper v. Virginia Dept. of Taxation*, 401 S.E.2d 868 (Va. 1991), *vacated*, 111 S.Ct. 2883 (1991), *on remand*, 410 S.E.2d 629 (Va. 1991), *cert. granted*, 60 U.S.L.W. 3770 (1992), because the state court in *Harper* applied *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), on a prospective-only basis, whereas in the instant case the Minnesota Supreme Court rejected prospective-only application of *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). (Resp. Br. 7-8.) Respondents then suggest that the "federal issues left unresolved by *McKesson* and *Beam* in connection with intergovernmental immunity cases are more fruitfully addressed in a case such as *Harper*." (Resp. Br. 8.)

In fact, the "federal issues left unresolved by *McKesson* and *Beam*" are squarely presented in this case in a way that indeed differs from *Harper*, but in a way that clearly merits a grant of certiorari. Both *Harper* and the instant case were remanded in light of *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). The Virginia Supreme Court employed prospectivity as a "choice-of-law principle" to defeat Harper's claim. The Minnesota Supreme Court, by contrast, employed prospectivity as a "remedial principle" to defeat Petitioners' claims. (Resp. Br. 27.) Of course, to a taxpayer who is unable to recover an unconstitutional tax the

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[1] Reference is made to the Rule 29.1 Statement of Petitioners included in their petition for certiorari. The statement remains accurate without amendment.

effect of the application of either principle is the same. Indeed, in this case the Minnesota Supreme Court, thwarted by *Beam* from reaffirming its original holding in which it employed choice-of-law prospectivity, simply relabeled its holding as remedial. While this Court has distinguished the two principles in its recent decisions, *compare Beam and American Trucking Ass'ns, Inc. v. Smith*, 496 U.S. 167 (1990) (choice-of-law prospectivity) *with McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990) (remedial prospectivity), the Court did not intend to allow the state courts to subvert choice-of-law prospectivity principles through the awarding of a prospective-only remedy, which is what the Minnesota Supreme Court did in this case.

In *McKesson*, this Court held that purely prospective relief from the imposition of an unconstitutional tax is a denial of due process *if* the state does not provide a "clear and certain" predeprivation remedy. As construed by the Minnesota Supreme Court, Minnesota law provided a "clear and certain" predeprivation remedy in the form of an appeal to the Minnesota Tax Court. (App. 9A-10A.) Citing the purported availability of this procedure, Respondents leap to the conclusion that "the threshold requirement for retroactive relief of any sort cannot be established . . . under *McKesson*." (Resp. Br. 14.) They also assert that "any due process issues which might otherwise be raised by the denial of refunds are obviated by the availability of a predeprivation right to challenge payment of the tax." (Resp. Br. 7.) Respondents conclusions, however, are based upon a gross misreading of *McKesson*.

The holding of *McKesson* is that retroactive relief *must* be provided if there is no prepayment procedure. Respondents have

taken this holding and inverted it. They claim *McKesson* stands for the proposition that retroactive relief can *always* be denied if a prepayment procedure exists. Indeed, according to Respondents there are no due process constraints at all in this situation. (Resp. Br. 7.) This inverted proposition, however, finds no support in the decision itself.

Respondents refer the Court to *McKesson's* footnote 21, wherein the Court stated that "the availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process Clause." 496 U.S. at 38 n.21. (Resp. Br. 10-11.) However, it is clear that the Court in footnote 21 was simply reaffirming the constitutionality of the common law rule that precludes refunds of a voluntarily paid tax. Minnesota, like the Federal Government, has abandoned this common law rule by adopting a refund statute permitting the recovery of a tax even if it is voluntarily paid.[2] (Pet. Br. 16.) Petitioners, who fully complied with the Minnesota refund statute, assert that they had a protectible property interest in the remedy allowed by the statute and that the Minnesota Supreme Court denied them due process by awarding prospective-only relief. (Pet. Br. 15-18.)

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[2] Congress abandoned the common law requirement of protest and duress in 1924. Revenue Act of 1924, c. 234, 43 Stat. 253, 343, § 1014 (1924). Describing the intent underlying the allowance of refunds for voluntarily paid taxes, Justice Cardozo noted that the act righted "an ancient wrong . . . A high-minded government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience." *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 379 (1933). A number of states in addition to Minnesota have similar refund statutes. (Pet. Br. 15.)

Neither *McKesson* nor any other decision of this Court has considered the entitlement to refunds where a state, following the federal income tax model, provides parallel prepayment and postpayment tax controversy procedures. *Harper* will not address this issue because the state court in *Harper* applied its concept of choice-of-law retroactivity without addressing the remedial issues. (Pet. Br. 8-10.) Thus, Respondents are wrong in asserting that the "federal issues left unresolved by *McKesson* and *Beam* . . . are more fruitfully addressed" in *Harper*, and they are wrong in claiming that "this case does not raise significant constitutional issues." (Resp. Br. 8.) The Minnesota Supreme Court has employed its notion of remedial prospectivity -- based on professed "equitable and reliance interests" -- to eviscerate this Court's holdings on choice-of-law prospectivity.[3] (Resp. Br. 27.) Whether a state court may do so without violating the Due Process Clause (and, in this case, the Supremacy Clause) *is* a substantial federal question that should be addressed by this Court. Accordingly, Petitioners request that the Court grant certiorari in this case, as it already has in *Harper*, to consider fully in the context of the intergovernmental immunity doctrine the right of a state to deny retroactive relief to a taxpayer who pays an unconstitutionally discriminatory tax.

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[3] Respondents persist in claiming a reliance interest without identifying any legal precedent upon which they might have relied. In fact, both Minnesota and federal cases prior to *Memphis Bank* had struck down state taxes that discriminated against federal obligations. *See State v. Duluth M. & N. Ry. Co.*, 207 Minn. 618, 292 N.W. 401 (1939), *reh'g denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940) (invalidating Minnesota tax that discriminated against federal obligations); *Schuykill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935) (holding that a state tax may not be imposed on federal obligations unless it is equally imposed on obligations issued by the state or any other person).

II. The Petitioners Did Not Have a "Clear and Certain" Prepayment Remedy.

Under Petitioners' primary contention, as discussed above, the Minnesota Supreme Court was obligated to recognize and give effect to Minnesota's refund statute. The existence or nonexistence of a prepayment remedy is irrelevant to this issue. Petitioners have argued in the alternative, however, that the instant case can be decided squarely under *McKesson* because the predeprivation remedy that Respondents claim was available to Petitioners -- appeal to the Minnesota Tax Court -- was not a "clear and certain" remedy for the 1979 taxable year at issue. (Pet. Br. 18-20.) An appeal to the Tax Court could not have been brought by Petitioners after the decisions in *Matter of McCannel*, 301 N.W.2d 960 (Minn. 1980) and *Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138 (Minn. 1980), which held that the Tax Court had no jurisdiction to decide constitutional issues in cases filed initially in that court.[4] (Pet. Br. 18-19.) Respondents nonetheless claim, citing *Nagaraja v. Commissioner of Revenue*, 352 N.W.2d 373 (Minn. 1984), and *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261 (Minn. 1984), that for the year at issue "Minnesota law clearly allowed an appeal to its tax court *without* prepayment." (Resp. Br. 14.)

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[4] Respondents claim that "prior to 1980" the Tax Court would have had jurisdiction. (Resp. Br. 12.) However, Petitioners did not file their 1979 tax returns until 1980, and the Commissioner would not have issued an order assessing tax until some considerable time after filing. Such an order was a prerequisite to Tax Court jurisdiction. Minn. Stat. § 271.06, Subd. 1 (1980). Thus, Respondents' point with respect to pre-1980 law is irrelevant. Moreover, it would be incorrect to conclude that the Tax Court offered a "clear and certain" prepayment remedy prior to 1980 since the Minnesota Supreme Court questioned the Tax Court's constitutional jurisdiction in a 1977 case. *See Harris v. Commissioner of Revenue*, 257 N.W.2d 568, 569 n.1 (Minn. 1977).

This claim by Respondents shows a remarkable degree of institutional amnesia, for the fact is that the Commissioner of Revenue routinely moved to dismiss for lack of jurisdiction constitutional claims filed in Tax Court subsequent to *McCannel* and *Guilliams*.[5] The Commissioner moved, for example, to dismiss the appeal brought in *Erie Mining*, but the Tax Court retained jurisdiction solely because the case had been filed prior to *Guilliams*. On appeal, the Minnesota Supreme Court affirmed this holding, reiterated that no jurisdiction existed post-*Guilliams*, and in dictum *for the first time* announced a procedure whereby a constitutional issue could be decided by the Tax Court if the court first referred the case to a district court and if the district court then referred it back to the Tax Court.[6] *Erie Mining*, 343 N.W.2d at 264. Citing *Nagaraja*, Respondents claim that the Petitioners

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[5] In response to these motions, the Tax Court held that it would retain jurisdiction of any appeal filed prior to *McCannel* and *Guilliams*. *Erie Mining Co. v. Commissioner of Revenue*, No. 2630 (Minn. Tax Ct. 1983), *aff'd on this ground*, 343 N.W.2d 261 (Minn. 1984); *Maland v. Commissioner of Revenue*, No. 3134 (Minn. Tax Ct. 1982); *and Hanson v. Commissioner of Revenue*, No. 2962 (Minn. Tax Ct. 1981). The court also held that it would retain jurisdiction over claims that a law "as applied" to a particular taxpayer was unconstitutional, as contrasted with claims questioning the constitutionality of a statute *per se*. *Fussard v. Commissioner of Revenue*, No. 3183 (Minn. Tax Ct. 1981). Since Petitioners challenged the constitutionality *per se* of the tax on federal obligation interest, their cases would have been dismissed for lack of subject matter jurisdiction if Petitioners had filed in Tax Court. *Cf. DeCoster v. Commissioner of Revenue*, No. 3207-S (Minn. Tax Ct. 1981) (Tax Court granted Commissioner's motion to dismiss claim that tax statute was unconstitutional).

[6] The Minnesota Supreme Court in a later case noted that "[i]t was not until our decision in [*Erie Mining*], however, that we specifically set out the procedure for enforcing the *McCannel* rule." *Soo Line Railroad Co. v. Commissioner of Revenue*, 377 N.W.2d 453, 456 n.1 (Minn. 1985).

somehow should have foreseen this circuitous procedure -- now referred to by the cognoscenti as the "*Erie* shuffle" -- prior to the *Erie Mining* decision. (Resp. Br. 14.) Respondents fail to note, however, that they themselves objected to the shuffle in *Nagaraja*. 352 N.W.2d at 374 n.1. Moreover, *Nagaraja* was a *refund* case, not a deficiency case, and therefore is inapposite to Respondents' claim that "Minnesota law clearly allowed an appeal to its tax court *without* prepayment." (Resp. Br. 14.) That claim is patently incorrect.

III. The Estoppel Holding of the Minnesota Supreme Court Is Unconstitutional.

Respondents claim that Petitioners "were forced to assert [that state obligation] exemptions were unlawful." (Resp. Br. 24.) To the contrary, Petitioners have consistently asserted that Minnesota's exemptions for its own bonds were lawful. Under federal constitutional and statutory law, the states are free to exempt state obligation interest from tax, and most states do so. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 75 (June, 1992). However, a state exempting its own bonds cannot impose a tax on federal obligation interest. Petitioners challenged Minnesota's tax on federal obligation interest, not the state obligation exemptions.

The cases cited by Respondents at page 22 of their brief stand for the proposition that one cannot retain the benefits of a statute while challenging one of its conditions. Minnesota's exemptions for state obligation interest, however, were not subject to a condition that the taxpayer pay a tax on federal obligation interest. *See* Minn. Stat. §§ 136.32 (1978) *and* 474.12 (Supp. 1979) (Pet. App. 74A-75A.) Thus, Petitioners should not have

been estopped from challenging the tax by the acceptance of benefits doctrine.[7]

Finally, Respondents make the puzzling suggestion that Petitioners would not have been estopped if they had proceeded with a prepayment appeal to the Minnesota Tax Court. (Resp. Br. 20.) However, it is beyond comprehension why, assuming Petitioners accepted "benefits" in a refund case, they would not also have accepted those same "benefits" in a prepayment case. In either case Petitioners would have excluded state obligation interest from income, and the only way in which Petitioners could have divested themselves of that purported "benefit" would have been to forego the exemption and pay a tax no one else had to pay on state obligation interest. It is for this reason that the estoppel holding of the Minnesota Supreme Court is unconstitutional. (Pet. Br. 22-23.)

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[7] It should be noted that each of the cases cited by Respondents involved the application of *federal* estoppel doctrine to defeat a federal right. The instant case, by contrast, involves an attempt to apply *state* estoppel doctrine to defeat a federal right. It should also be noted that, while Petitioners excluded state obligation interest from income as they were entitled to do under state law, they did not thereby "reduce" their tax liability (Resp. Br. 27) except in the purely hypothetical sense that they could instead have bought taxable bonds. However, in buying state obligations Petitioners had to accept lower interest rates. (Pet. App. 45A.) Thus, the benefit of the exemptions went to the issuers of state obligations, not to Petitioners. (Pet. Br. 23.)

IV. Conclusion.

For the reasons set forth above and in the Petition for Certiorari, Petitioners request that their Petition for Certiorari be granted.

Respectfully submitted,

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